

**H.R. 6040, “CONTINUED FREE
ASSOCIATION WITH PALAU
ACT OF 2012”; AND H.R. 6147,
“RONALD WILSON REAGAN
EXCLUSIVE ECONOMIC ZONE
OF THE UNITED STATES”**

LEGISLATIVE HEARING

BEFORE THE

SUBCOMMITTEE ON FISHERIES, WILDLIFE,
OCEANS AND INSULAR AFFAIRS

OF THE

COMMITTEE ON NATURAL RESOURCES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

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LEGISLATIVE HEARING ON H.R. 6040, TO APPROVE THE AGREEMENT PROVIDING TERMS FOR A CONTINUATION OF THE FREE ASSOCIATION BETWEEN THE UNITED STATES AND PALAU, AND FOR OTHER PURPOSES. "CONTINUED FREE ASSOCIATION WITH PALAU ACT OF 2012"; AND H.R. 6147, TO DESIGNATE THE EXCLUSIVE ECONOMIC ZONE OF THE UNITED STATES AS THE "RONALD WILSON REAGAN EXCLUSIVE ECONOMIC ZONE OF THE UNITED STATES".

**Monday, September 10, 2012
U.S. House of Representatives
Subcommittee on Fisheries, Wildlife, Oceans and Insular Affairs
Committee on Natural Resources
Washington, D.C.**

The Subcommittee met, pursuant to call, at 2:28 p.m., in Room 1334, Longworth House Office Building, Hon. John Fleming [Chairman of the Subcommittee] presiding.

Present: Representatives Fleming, Sablan, Faleomavaega, and Bordallo.

STATEMENT OF THE HON. JOHN FLEMING, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF LOUISIANA

Dr. FLEMING. The Subcommittee will come to order. The Chairman notes the presence of a quorum. Good afternoon. Today we are holding a legislative hearing on H.R. 6040, the Continued Free Association with Palau Act of 2012. And because of some last minute changes, we will not be hearing our second panel today. H.R. 6040 was introduced by Congressman Donald Manzullo, Chairman of the House Foreign Affairs Subcommittee on Asia and the Pacific. His legislation would implement the 15-year review that was conducted pursuant to Section 432 of the Compact.

The Foreign Affairs and Natural Resources Committees shared jurisdiction over this issue. This Committee's oversight responsibilities cover the Department of the Interior's role in implementing the Compact's funding provisions.

It has been a long road in getting to this point to having a hearing on this issue. The Administration forwarded the proposal to Congress in January 2011. While the Administration's draft bill was not introduced in the House, the intent of it and H.R. 6040 are the same. Implementation of the 15-year review agreement signed by the U.S. and Palau.

The Compact with Palau went into effect in 1994. The first 15-year review was scheduled for 2009, but was delayed due to the transition between the Bush and Obama Administrations. The renegotiated agreement was signed by both parties in September 2010. Under the Compact, Palau is self-governing, conducts its own foreign affairs and regulates its domestic and foreign communications. The Compact gives the U.S. full authority and responsibility for security and defense matters relating to Palau.

As a member of the House Armed Services Committee, I am familiar with the Administration's pivot to Asia, the current concerns within the region and how the Compact provides the U.S. with the options for forward positioning of military assets in the region. The Compact also provides financial assistance, including direct economic assistance and access to Federal programs to Palau. While the proposed financial package of \$427 million, with \$215 million in mandatory funds is substantially less than the \$825 million, with \$411 million in direct assistance provided to Palau in the first 15-year period of the Compact, the new funding will need to be fully offset as required by the Rules of the House.

H.R. 6040 is introduced and included in some offsets for the mandatory funding. At the Asia and Pacific Subcommittee markup, these offsets were replaced with an offset which would allow the Secretary of State to deny passports to individuals with tax debts over \$50,000. It is my understanding that this offset may not work as drafted and an alternative approach may be necessary.

I am interested to hear from the Administration witnesses to see if they can recommend any new offset proposals. The previously recommended offsets regarding net receipt sharing of energy and mineral receipts, coal mining reforms and fees on nonproducing oil and gas leases are not acceptable to either the House or Senate committees.

Today's hearing is an important opportunity to discuss the Palau Compact and provide Members with the information on the benefits of the agreement to the United States and the Republic of Palau.

It is unfortunate that the Department of Defense decided to submit only written testimony. One of the points given to support the Compact is national defense. I believe their presence would have been useful at this hearing.

The second bill—I am sorry, we are not going to take up the second bill. Oh, we are? OK, I am sorry. The second bill we will examine is H.R. 6147 introduced by the Chairman of the Committee on Oversight and Government Reform, Congressman Darrell Issa of California. This proposal will designate our exclusive economic zone as the Ronald Wilson Reagan Exclusive Economic Zone of the United States. This a fitting tribute to our 40th President who established our 200-mile zone by signing a Presidential Proclamation on March 10, 1983.

Ronald Reagan was one of our Nation's greatest Presidents. As someone who grew up during the darkest days of the Cold War, I will always be grateful that because of his peace through strength doctrine, the Cold War ended and the Soviet Union collapsed. President Reagan was also responsible for proposing the largest tax cut in our Nation's history. And when he left office in 1989, our na-

tional debt was \$2.6 trillion. Today it is 8 times higher and has increased more than \$5 trillion during just the last 4 years. While some may characterize this designation as trivial, I strongly disagree and I am pleased to support this effort. I compliment the gentleman from California for his leadership on behalf of the Great American patriot, who is fond of telling us that America was truly that shining city upon a hill.

[The prepared statement of Dr. Fleming follows:]

**Statement of The Honorable John Fleming, Chairman,
Subcommittee on Fisheries, Wildlife, Oceans and Insular Affairs**

Good afternoon, today we are holding a legislative hearing on H.R. 6040, the Continued Free Association with Palau Act of 2012 and H.R. 6147, the Ronald Wilson Reagan Exclusive Economic Zone of the United States.

H.R. 6040 was introduced by Congressman Donald Manzullo, Chairman of the House Foreign Affairs Subcommittee on Asia and the Pacific. His legislation would implement the 15-year review that was conducted pursuant to Section 432 of the Compact. The Foreign Affairs and Natural Resources Committee's share jurisdiction over this issue. This Committee's oversight responsibilities cover the Department of the Interior's role in implementing the Compact's funding provisions.

It's been a long road in getting to this point to have a hearing on this issue. The Administration forwarded a proposal to Congress in January of 2011. While the Administration's draft bill was not introduced in the House, the intent of it and H.R. 6040 are the same—implementation of the 15-year review agreement signed by the U.S. and Palau.

The Compact with Palau went into effect in 1994. The first 15-year review was scheduled for 2009, but was delayed due to the transition between the Bush and Obama Administrations. The renegotiated agreement was signed by both parties in September of 2010.

Under the Compact, Palau is self-governing, conducts its own foreign affairs and regulates its domestic and foreign communications. The Compact gives the U.S. full authority and responsibility for security and defense matters relating to Palau. As a member of the House Armed Services Committee, I am familiar with Administration's pivot to Asia, the current concerns within the region and how the Compact provides the U.S. with options for forward positioning of military assets in the region.

The Compact also provides financial assistance, direct economic assistance, and access to federal programs to Palau. While the proposed financial package of \$215 million is substantially less than the \$852 million provided to Palau in the first 15-year period of the Compact, it is funding that will need to be fully offset as required by the Rules of the House. H.R. 6040 as introduced included some offsets for the mandatory funding. At the Asia and the Pacific Subcommittee markup, these offsets were replaced with an offset which would allow the Secretary of State to deny passports to individuals with tax debts over \$50,000. It is my understanding that this offset may not work as drafted and an alternative approach may be necessary.

I am interested to hear from the Administration witnesses to see if they can recommend any new offset proposals. The previously recommended offsets regarding "net receipts sharing" of energy and mineral receipts, coal mining reforms and fees on nonproducing oil and gas leases are not acceptable to either the House or Senate Committees.

Today's hearing is an important opportunity to discuss the Palau Compact and provide Members with information on the benefits of the agreement to the United States and the Republic of Palau.

The second bill we will examine is H.R. 6147, introduced by the Chairman of the Committee on Oversight and Government Reform, Congressman Darrell Issa of California.

This proposal will designate our Exclusive Economic Zone as the Ronald Wilson Reagan Exclusive Economic Zone of the United States. This is a fitting tribute to our 40th President who established our 200-mile zone by signing a Presidential Proclamation on March 10, 1983.

Ronald Reagan was one of our nation's greatest Presidents. As someone who grew up during the darkest days of the Cold War, I will always be grateful that because of his "Peace through Strength" Doctrine, the Cold War ended, the Soviet Union collapsed.

President Reagan was also responsible for proposing the largest tax cut in our nation's history and when he left office in 1989, our national debt was \$2.6 trillion. Today, it is eight times higher and it has increased more than \$5 trillion during just the last four years.

While some may characterize this designation as trivial, I strongly disagree and I am pleased to support this effort. I compliment the gentleman from California for his leadership on behalf of a great American patriot who was fond of telling us that America was truly that "Shining City Upon A Hill".

Dr. FLEMING. I now recognize the Ranking Member for any statement he would like to make at this time.

**STATEMENT OF THE HON. GREGORIO KILILI CAMACHO
SABLAN, A DELEGATE IN CONGRESS FROM THE TERRITORY
OF THE NORTHERN MARIANA ISLANDS**

Mr. SABLAN. Thank you very much, Mr. Chairman, and good afternoon everyone. We are here today to receive testimony on two bills, H.R. 6040, to approve the agreement providing for a continuation of the free association between the United States and Palau, and H.R. 6147, to designate the Exclusive Economic Zone of the United States as the Ronald Wilson Reagan Exclusive Economic Zone of the United States.

I want to begin by thanking you for calling this hearing so expeditiously after Foreign Affairs Committee Chairwoman Ros-Lehtinen made the decision to discharge H.R. 6040 from the Committee. I also want to thank Asia and Pacific Subcommittee Chairman, Don Manzullo, and my Subcommittee colleague, Eni Faleomavaega for introducing H.R. 6040.

I grew up in the territory, of which Palau was a part, and I represent islands that are close by. I have observed from the front line the relationship between the United States and Palau all my life. The Secretary of Foreign Affairs of Palau was my classmate in high school in Chook. And I feel a special closeness to Palau and responsibility for it beyond my role as the Ranking Member of this Subcommittee.

When Palau was a territory, this subcommittee's predecessor had lead jurisdiction in the House regarding legislation concerning it. Now that it is a sovereign state in free association with the United States, lead jurisdiction is in the Asia and Pacific Subcommittee. This bill has been referred to the Natural Resources Committee and our Subcommittee primarily because of the provision that would require the Secretary of the Interior to report to the Committees on Foreign Affairs and Natural Resources, and the Senate Committee on Energy and Natural Resources annually on newest programs in Palau otherwise considered domestic. The Secretary also has responsibility for administering special assistance given to Palau which implicates our jurisdiction. But the Committee on Foreign Affairs has the jurisdiction regarding the types and levels of assistance and other policies concerning Palau.

The United States took Palau and other Micronesian Islands that became the territory I mentioned from Japan through some the bloodiest battles of World War II and governed it for half a century under an agreement with the United Nations that required economic and social assistance and eventual self-government. To preserve strategic control over the islands of the self-government, our

government encourages the status of free association as an alternative to independence and extended domestic programs.

The Compact of Free Association negotiated by the Reagan Administration approved by law by the George H.W. Bush Administration preserved United States strategic authority over the lands and waters of Palau and confirms space rights for 50 years. It also requires bilateral negotiations on continuing their relationship and to determine United States assistance and the 15, 30 and 40-year marks of this 50 years.

The Asia and Pacific Subcommittee bill would approve an agreement approved by the 15th anniversary negotiations, and slightly modified to address Palauan concerns. Continued arrangements, the Reagan negotiated compact and be consistent with the revised Compacts of Free Association with the two other Pacific states that came out of the territory as approved by the Republican Congress in 2003. That approval included some Congressional modifications to the negotiated Compact.

President Toribiong of Palau wrote 3 months ago that the 21 months that have elapsed since the agreement was signed has caused an increasing number of Palauans to question their agreement and the commitment of the United States to the free association relationship. And resulted in some Palauans being enticed by the potential assistance from China and offers of funding from Arab nations.

The Defense Department has advised that failure to follow through under the commitments to Palau as reflected in the proposed agreed legislation would jeopardize our defense posture in the Western Pacific, which will become increasingly important. It says that Palau is irreplaceable because it covers a strategic expanse of the Pacific as large as the State of Texas, and the free association right of the U.S. to deny access to other nations prevents China from using ceilings that it wants to develop its economy and increase its military protection in the region.

The State Department additionally said that continuing the association is vital, in addition because Palau votes with the United States in the United Nations more than any other member—which is especially important on issues such as Israel.

Mr. Chairman, the agreement was signed 2 years and 1 week ago. The Executive Branch asked us to approve it at the beginning of this Congress. A number of leaders in both parties, in both Houses have supported the agreement from the first, and no Member has criticized it. The only problem with approval has been how to offset the cost. We should do our part and act to facilitate House passage as soon as possible. Mr. Chairman, I would like insert for the record my full statement, my opening statement, and I yield back the balance of my time.

Dr. FLEMING. Without objection so ordered. The gentleman yields back.

[The prepared statement of Mr. Sablan follows:]

Statement of The Honorable Gregorio Kilili Camacho Sablan, Ranking Member, Subcommittee on Fisheries, Wildlife, Oceans and Insular Affairs

Thank you Mr. Chairman. We are here today to receive testimony on two bills: H.R. 6040, to approve the Agreement providing for a continuation of the free association between the United States and Palau and H.R. 6147, to designate the exclu-

sive economic zone of the United States as the “Ronald Wilson Reagan Exclusive Economic Zone of the United States”.

I want to begin by thanking you for calling this hearing so expeditiously after Foreign Affairs Committee Chairwoman Ros-Lehtinen took the decision to discharge H.R. 6040 from that committee. I also want to thank Asia and the Pacific Subcommittee Chairman Don Manzullo and our Subcommittee colleague, Eni Faleomavaega for introducing H.R. 6040.

I grew up in the territory of which Palau was a part, and represent islands that are close by. I have observed from the front line the relationship between the United States and Palau all of my life. And I feel a special closeness to Palau and responsibility for it beyond my role as the Ranking Member of this Subcommittee.

When Palau was a territory, this Subcommittee’s predecessor had lead jurisdiction in the House regarding legislation concerning it. Now that it is a sovereign state in free association with the U.S., lead jurisdiction is in the Asia and the Pacific Subcommittee.

This bill has been referred to the Natural Resources Committee and our Subcommittee primarily because of the provision that would require the Secretary of the Interior to report to the Committees on Foreign Affairs and Natural Resources and the Senate Committee on Energy and Natural Resources annually on U.S. programs in Palau otherwise considered domestic. The Secretary also has responsibilities for administering special assistance given Palau, which implicates our jurisdiction. But the Committee on Foreign Affairs has the jurisdiction regarding the types and levels of assistance and other policies concerning Palau.

The United States took Palau and the other Micronesian Islands that became the territory I mentioned from Japan through some of the bloodiest battles of World War Two and governed it for half a century under an agreement with the United Nations that required economic and social assistance and eventual self-government. To preserve strategic control over the islands after self-government, our government encouraged the status of free association as an alternative to independence and extended domestic programs. The Compact of Free Association negotiated by the Reagan Administration approved by law under the George H.W. Bush Administration preserved U.S. strategic authority over the lands and waters of Palau and confers base rights for 50 years. It also requires bilateral negotiations on continuing the relationship and to determine U.S. assistance at the 15, 30 & 40-year marks of this 50 years.

The Asia and the Pacific Subcommittee bill would approve an agreement approved by the 15th anniversary negotiations and slightly modify it to address Palauan concerns, continue arrangements of the Reagan-negotiated Compact, and be consistent with the revised compacts of free association with the two other Pacific states that came out of the territory, as approved by the Republican Congress in 2003. That approval also included some congressional modifications to the negotiated compacts.

President Toribiong of Palau wrote three months ago that “[t]he 21 months that have elapsed since the Agreement was signed has caused an increasing number of Palauans to question the Agreement and the commitment of the United States to the free association relationship” and “resulted in some Palauans being enticed by the potential of assistance from China and offers of funding from Arab nations.”

The Defense Department has advised that “[f]ailure to follow through on our commitments to Palau, as reflected in the proposed legislation, would jeopardize our defense posture in the Western Pacific” which “will become increasingly important”. It says that Palau is “irreplaceable” because it covers a strategic expanse of the Pacific as large as Texas, and the free association right of the U.S. to deny access to other nations prevents China from using sea-lanes that it wants to develop its economy and increase its military projection in the region. The State Department additionally says that continuing the association is “vital”, in addition because Palau votes with the United States in the United Nations more than *any* other member—which is especially important on issues such as Israel.

Mr. Chairman, the Agreement was signed two years and one week ago. The Executive branch asked us to approve it at the beginning of this Congress. A number of leaders of both parties in both houses have supported the Agreement from the first, and no Member has criticized it. The only problem with approval has been how to offset the cost. We should do our part and act to facilitate House passage as soon as possible.

Our second bill, H.R. 6147, was introduced by our colleague Representative Darrell Issa, would rename the U.S. Exclusive Economic Zone (E.E.Z.) after our 40th President, Ronald Wilson Reagan. As we all know, the framework that allows countries to peacefully claim as sovereign territory the E.E.Z.s off of their shores is the United Nations Convention on the Law of the Sea (Convention). Since it was adopted in 1982, Presidents and Secretaries of State from both political parties, as well

as top U.S. military leaders have expressed strong support for joining Convention. Unfortunately, President Reagan was not among them.

Ratifying the Convention is critical for our economy and our national security. While claiming the E.E.Z. was a step in the right direction, our grade on ensuring the American people a seat at the table when global ocean governance issues are being discussed is an 'incomplete.' 162 other countries have ratified the Convention, and are deciding on rules for accessing outer continental shelf resources, mining the seabed and navigating in international waters. We are on the outside looking in. I hope that, as we recognize the importance of our E.E.Z., we can also express our support to the Senate as they consider ratification of the Convention this fall.

Thank you again Mr. Chairman. I look forward to hearing from our witnesses.

Dr. FLEMING. We are now ready for our panel of witnesses, which includes The Honorable Anthony M. Babauta, Assistant Secretary of the Interior for Insular Affairs. Department of the Interior; The Honorable Edward D. Kagan, Deputy Assistant Secretary, Bureau of East Asian and Public Affairs with the Department of State; and Mr. David Gootnick, hopefully that is correct, Director, International Affairs and Trade with the Government Accountability Office.

And before we call upon them to testify, I ask unanimous consent to add the statements from both Congressman Manzullo and Issa to the hearing record. Hearing no objection, so ordered.

[The prepared statement of Mr. Issa follows:]

**Statement of The Honorable Darrell E. Issa, a Representative in Congress
from the State of California**

I would like to start by thanking Chairman Fleming and Ranking Member Sablan for bringing up my bill H.R. 6147, the "Ronald Wilson Reagan Exclusive Economic Zone of the United States," for consideration. I would also like to thank Chairman Hastings and Ranking Member Markey, of the full committee.

On March 10, 1983 President Ronald Reagan nearly doubled the size of the United States with the stroke of his pen, at no cost to taxpayers, when he issued Proclamation 5030, establishing the United States Exclusive Economic Zone (EEZ). The EEZ extends U.S. sovereignty over all waters, animals, the seabed and the subsoil, up to 200 nautical miles off America's coast, as well as off the coasts of Puerto Rico, the Northern Mariana Islands and other U.S. territories and possessions. The EEZ is consistent with domestic and international law, and ensures that the United States has sovereign rights for the purpose of exploring, exploiting, conserving, and managing living and nonliving resources off our coasts.

We currently have the largest EEZ in the world, spanning over 13,000 miles of coastline and reaching the Gulf of Mexico, Caribbean Sea, Atlantic Ocean, and Pacific Ocean. President Reagan appreciated that America is blessed with an abundance of natural resources and understood that to remain competitive and to promote strong economic growth, we need to effectively develop and responsibly make use of our natural wealth.

While policy debates about the management of our EEZ will certainly continue, the establishment of an EEZ is widely recognized around the world to be an essential component of marine conservation, resource management, and national competitiveness. As we strive to meet the challenges of maintaining our vast sovereign areas, we must also recognize the abundant opportunity that Ronald Reagan provided our nation when he first established our EEZ.

In closing, I would once again like to thank Chairman Fleming and Ranking Member Sablan for bringing this bill before the Subcommittee on Fisheries, Wildlife, Oceans, and Insular Affairs and for the chance to be here. This legislation will honor President Reagan's leadership and foresight in protecting U.S. interests and I look forward to seeing this bill brought to the House floor and eventually signed into law.

[The prepared statement of Mr. Manzullo follows:]

**Statement submitted for the record by The Honorable Donald A. Manzullo,
Chairman, Subcommittee on Asia and the Pacific, House Committee on
Foreign Affairs**

Chairman Fleming, thank you for allowing me the opportunity for me to address the Subcommittee. The revised Compact of Free Association agreement with the Republic of Palau is a significant topic of discussion, and I am grateful your Subcommittee is holding this hearing to bring more attention to the issue.

The Compact with Palau was negotiated in the 1980s at the height of the Cold War with the goal of establishing democratic self-governance and economic self-sufficiency in Palau, while preserving strategic control of the Western Pacific. Although it was completed in 1986, it did not enter into force for another eight years. Thus in 1994, the United States and the Republic of Palau implemented a Compact of Free Association ending 49 years of direct American administration under the auspices of the United Nations' Trust Territory of the Pacific Islands.

The Compact provided for several types of assistance, including direct economic assistance for 15 years to the Palau government, establishment of a trust fund to provide Palau \$15 million in annual payments from 2010 to 2044, infrastructure investments, and the provision of federal services such as postal, weather, and aviation. The Government Accountability Office, which is represented here today, estimated that Palau received a total of \$852 million between 1995 and 2009.

In late 2010, the Administration completed a 15-year review of the Compact, as required under the terms of the agreement, and intended to provide Palau a total of \$215 million through the next 15-year agreement period. This revised agreement does not change the fundamental provisions of the original Compact; however, it does gradually reduce the financial support provided by the U.S. and extends the life of the agreement to 2024. More importantly, the revised agreement greatly improves the likelihood of the existing trust fund's ability to sustain payments through to 2044, as originally planned. It also requires visitors from Palau to have a machine readable passport to enter the U.S., and it conditions future financial assistance on Palau's progress in achieving key economic reforms.

In late June of this year I introduced H.R. 6040, which will approve the revised Compact agreement, certify the United States' commitment to Palau, and secure our vital interests in the Western Pacific. It is with utmost urgency that your committee moves this bill forward and helps push the approval of the Compact with Palau out of its nearly two-year deadlock in Congress.

Palau is an important friend in the Asia-Pacific region. It is one of six Pacific Island nations to have diplomatic ties with Taiwan rather than China. According to the Department of Defense, Palau is irreplaceable because it covers a strategic expanse of the Pacific as large as Texas and gives the U.S. the right to deny other nations access to Palau's land and waterways. This prevents nations like China from using sea-lanes that it wants to develop its economic and military projection in the region. In addition, Palau supports the U.S. on 90 percent of the votes regarding Israel at the United Nations.

In a letter to President Obama, President Toribiong of Palau describes that during the 21 months that have lapsed since the agreement was signed, an increasing number of Palauans have begun to question the United States' commitment to the relationship, resulting in the temptation to accept assistance offers from China, various Arab nations, or Cuba. I request that this letter be included in the record and stress that we cannot let this happen.

Over the past few decades, the relationship with Palau has evolved into a strong partnership with people who share American values and closely identify with the U.S. With a number of leaders on both sides of the aisle in both chambers of Congress supporting the agreement, it is critical that Congress approves the agreement, outlined in H.R. 6040, to ensure the relationship stays steadfast and strong.

Chairman Fleming, thank you again for your continued support and I look forward to working with you in the near future to finally approve the revised Compact of Free Association with Palau.

Dr. FLEMING. Of course, you guys have appeared before us a number of times, you are well experienced with how we run our clocks and our microphones. As you know, your written testimony will appear in full in the hearing record, so I ask that you keep your oral statements to 5 minutes as outlined in our invitation letter to you and under Committee Rule 4(a). Our microphones are not automatic, so please press the button when you are ready to

begin. And the most common mistake is the mouthpiece is not close enough to the mouth, so please observe that.

I also want to explain how our timing lights work, very simply, you have 5 minutes, you are in the green light for the first 4, yellow light for the last 1 minute, and if you are still giving your testimony at that point and the light turns red, we ask that you go ahead and conclude your remarks. Your entire statement will be entered into the record.

Secretary Babauta, I now recognize you, sir, for 5 minutes to present your testimony on behalf of the Department of the Interior.

STATEMENT OF HON. ANTHONY M. BABAUTA, ASSISTANT SECRETARY, OFFICE OF INSULAR AFFAIRS, U.S. DEPARTMENT OF THE INTERIOR

Mr. BABAUTA. Thank you very much, Mr. Chairman, and members of the Subcommittee. I am pleased to be here today to discuss H.R. 6040 and H.R. 6147. With regard to H.R. 6040, my statement will focus on the financial assistance in the new agreement with Palau. The Compact of Free Association with Palau has proven to be a very successful framework for United States-Palau relations. The goals of the first 15 years of the Compact have been met. The trusteeship was terminated; Palau self-government was restored; a stable democratic state was established; third countries were denied military influence in the region of Palau; and with the United States financial assistance a base for economic growth has been provided.

The original financial terms and conditions of the Compact have been fully implemented by the U.S. and Palau, and Palau has made strong economic gains under the Compact of Free Association. Its growth in real terms has averaged just over 2 percent per year. Palau has taken control of its destiny and is moving in the right direction. As both the U.S. and Palau began their Compact review several years ago, the U.S. and Palau agreed that economic growth would rely on four key factors.

The first is the trust fund's ability to return \$15 million a year; the second, fiscal reforms to shrink Palau's public sector and raise revenue; the third, increase foreign investment and private sector growth; and four, continuation of certain U.S. assistance. The new agreement addresses these concerns. It extends U.S. assistance in declining annual amounts through Fiscal Year 2024. The total of direct financial assistance to Palau under this agreement is \$229 million. Although \$26.2 million of that amount has already been appropriated for direct economic assistance by Congressional action in Fiscal Year 2010 and in Fiscal Year 2011. An additional \$13.1 million in direct economic assistance has been appropriated to Palau for Fiscal Year 2012.

The amount of direct assistance will decline every year. The declining amount of assistance is intended to provide an incentive for Palau to develop other sources of local revenue and the Palauan Government will need to make systemic adjustments in order to live within the same resources. The agreement contains five categories of financial assistance for Palau: The first is direct economic assistance for education, health and the administration of justice and public safety; the second is infrastructure projects that

are mutually agreed in the amount of \$8 million in 2011 through 2013; \$6 million in 2014; and \$5 million in both 2015 and 2016.

The third category is infrastructure maintenance funds for capital projects previously financed by the United States. From 2011 through 2024, the U.S. Government will have contributed \$2 million annually, and the Palau government will have contributed \$600,000 annually to the fund.

The fourth category is the fiscal consolidation fund. The United States will have provided grants of \$5 million in each 2011 and 2012 to help the Palau government reduce its debt. Category 5 is the trust fund. The United States will contribute \$3 million annually from 2013 to 2022 and contribute \$250,000 in 2023 and Palau will delay withdrawals from the trust fund. Under the agreement withdrawals from the trust fund may only be used for education, health, administration of justice and public safety.

We recommend several changes to H.R. 6040 with regard to the subsidy for the United States Postal Service, we recommend striking the second sentence of subsection 105(e). We also propose language to facilitate financing of the agreement.

And finally, in language concerning an annual report we recommend that the consultation provisions be amended to require Federal agencies that administer such programs to submit annually to the Secretary of the Interior appropriate material ready for inclusion in the reports.

Under the new agreement, the U.S. and Palau will work cooperatively through one, an advisory group on economic financial and management reform, annual bilateral economic consultations and the provision of other U.S. services and programs to the U.S. Postal Service, the National Weather Service, and FAA and the Departments of Education and Health and Human Services. The Palau Compact legislative proposal does have PAYGO costs. In the past, the Administration has proposed a number of offsets and H.R. 6040 would provide a number of offsets to provide offsets for the Palau agreement.

The Administration looks forward to continuing the U.S. partnership of Palau, and the Department of the Interior is proud of the positive advancements U.S. assistance has achieved in Palau since 1995 and looks forward to the progress that we anticipate will be made over the period of new agreement.

With regard to H.R. 6147, the exclusive economic zone of the United States is a zone contiguous of the territorial sea of the United States which generally extends 200 nautical miles from the U.S. coastline. The EEZ applies to waters adjacent to the United States and United States territories and possessions. It is the largest in the world spanning over 13,000 miles of coastline, larger than combined land area of all 50 States.

H.R. 6147 would designate the EEZ as the Ronald Wilson Reagan Exclusive Economic Zone of the United States. And although the geographic range of the EEZ is relevant to certain elements of the Department's jurisdiction, the naming of EEZ does not affect any of the Department's existing authorities or programs. The Department notes that it is not aware of my precedence for a designation of this type and therefore the Department takes no position on H.R. 6147. Thank you very much, Mr. Chairman.

Dr. FLEMING. Thank you Mr. Babauta, thank you for your testimony.

[The prepared statement of Mr. Babauta follows:]

**Statement of Anthony M. Babauta, Assistant Secretary of the Interior—
Insular Areas, U.S. Department of the Interior**

Chairman Fleming and members of the Subcommittee, I am pleased to be here today to discuss H.R. 6040 which would approve the agreement between the Government of the United States and the Government of the Republic of Palau following the Compact of Free Association section 432 review, and H.R. 6147 designating the U.S. Exclusive Economic Zone as the “Ronald Wilson Reagan Exclusive Economic Zone of the United States. My colleagues from the Departments of State and Defense will discuss the importance of the United States—Palau relationship as it relates to national security and our policies in the Pacific. My statement today regarding Palau will focus on the financial assistance components of the new agreement with Palau for which the Department of the Interior will be responsible.

H.R. 6040

THE UNITED STATES—PALAU RELATIONSHIP

The Department of the Interior and the Government of Palau have been partners since 1951, when the Navy transferred to the Department of the Interior the administration of the United Nations Trust Territory of the Pacific Islands. Since the end of World War II, Palau has emerged from its status as a war-ravaged protectorate to become a sovereign nation and member of the world community. Consistent with the provisions of the 1994 Compact of Free Association, Palau has exercised its sovereignty in accordance with the principles of democracy and in a firm alliance with the United States.

The Compact of Free Association has proven to be a very successful framework for United States—Palau relations. The goals of the first fifteen years of the Compact have been met: the trusteeship was terminated; Palau’s self-government was restored; a stable democratic state was established; third countries were denied military influence in the region of Palau; and with United States financial assistance, a base for economic growth has been provided.

The original financial terms and conditions of the Compact have been fully implemented by the United States and Palau. The United States, through the Department of the Interior, has provided over \$600 million of assistance including \$149 million used to construct the 53-mile road system on the island of Babeldaob and \$38.7 million for health care and education block grants. Most of the funding, \$400 million, was expended on activities defined under Title Two of the Compact, which included general government operations, energy production, communications, capital improvements, health and education programs and establishment of the Compact Trust Fund.

The Compact Trust Fund was an important feature of U.S. assistance. Capitalized with \$70 million during the first three years of the agreement in the 1990s, the objective of the trust fund was to produce an average annual amount of \$15 million as revenue for Palau government operations for the thirty-five year period fiscal year 2010 through fiscal year 2044. The fund also generated \$5 million in annual operational revenue for Palau since the fourth year of the agreement, totaling \$60 million for the years 1998 through 2009.

Palau has made strong economic gains under the Compact of Free Association. Its growth, in real terms, has averaged just over two percent per year. Palau’s governmental services are meeting the needs of its community. Palau has taken control of its destiny and is moving in the right direction.

COMPACT REVIEW

As both the United States and Palau began the required Compact section 432 review several years ago, each side took pride in the growth evident in Palau. However, the review, which examined the terms of the Compact and its related agreements and the overall nature of the bilateral relationship, also focused attention on several important issues. The United States and Palau agreed that prospects for continued economic growth relied on four key factors: 1) the viability of the Compact trust fund and its ability to return \$15 million a year; 2) the implementation of fiscal reforms to close the gap between Palau’s revenues and expenditures by shrinking its public sector and raising revenue; 3) the promotion of increased foreign investment and private sector growth, and, 4) the continuation of certain United

States assistance, including access to United States Federal domestic programs and services.

From the perspective of the United States, the viability of the Compact Trust Fund was of paramount concern. The economies of Pacific Islands are always fragile; their size, distance from markets and relative lack of resources make growth a perennial problem. Although Palau has some relative advantages in contrast to other Pacific island countries, the Compact Trust Fund was established with the intention of providing a relatively secure revenue base for Palau's government through fiscal year 2044. As the 15-year review began, Palau's trust fund, which had earned roughly 9 percent annually since its inception, had suffered significant losses. As GAO reported in 2008, it was uncertain that the trust fund could pay \$15 million annually to the Government of Palau through fiscal year 2044.

COMPACT AGREEMENT

The condition of the Compact Trust Fund, the need for fiscal and economic reforms, and the goal of strengthening conditions for private sector growth became the focus of the bilateral review. The *Agreement Between the Government of the United States of America and the Government of the Republic of Palau Following the Compact of Free Association Section 432 Review* (Agreement) that arose from the 15-year review, will address these concerns, maintain stability, promote economic growth and increase the progress already made under the Compact of Free Association.

The Agreement extends United States assistance, in declining annual amounts, through fiscal year 2024. The total of direct financial assistance to Palau under the Agreement is \$229 million, although \$26.2 million of that amount has already been appropriated for direct economic assistance by congressional action in fiscal year 2010 and in fiscal year 2011. An additional \$13.1 million in direct economic assistance has been appropriated to Palau in FY 2012.

Under the Agreement, in 2011 the United States was to provide Palau \$28 million, of which \$13 million is the aforementioned direct assistance. The amount will decline every year thereafter. The declining amount of assistance is intended to provide an incentive for Palau to develop other sources of local revenue and serves notice that the Palauan government has agreed that it will need to make systemic adjustments to its government in order to live within those same resources.

The Agreement contains five categories of financial assistance for Palau. Although I will discuss the Agreement as written, I note that H.R. 6040 appropriately shifts funding from the originally stated fiscal years to allow for implementation in the current year.

Direct economic assistance. The Agreement provides for direct assistance for education, health, administration of justice and public safety, in amounts starting at \$13 million in 2011, declining to \$2 million, the last payment, in 2023. As discussed below, this "glidepath" is coupled with a gradual increase in how much Palau can withdraw from its trust fund. The timing of direct assistance payments is conditioned on Palau's making certain fiscal reform efforts. If the United States government determines that Palau has not made meaningful progress in implementing meaningful reforms, direct assistance payments may be delayed until the United States Government determines that Palau has made sufficient progress on the reforms.

Infrastructure projects. Under the Agreement the United States is to provide grants to Palau for mutually agreed infrastructure projects—\$8 million in 2011 through 2013, \$6 million in 2014, and \$5 million in both 2015 and 2016. The Agreement does not name any projects.

Infrastructure maintenance fund. Under the Agreement, a trust fund will be established to be used for maintenance of capital projects previously financed by the United States, including the existing Compact Road. From 2011 through 2024, the United States government will have contributed \$2 million annually and the Palau government will contribute \$600,000 annually to the fund. This will protect crucial United States investments in Palau that significantly contribute to economic development.

Fiscal consolidation fund. The United States will have provided grants of \$5 million each in 2011 and 2012 to help the Palau government reduce its debt. United States creditors must receive priority, and the Government of Palau must report quarterly on the use of the grants until they are expended. This fund will also simplify needed economic adjustments to Palau's fiscal policies.

Trust fund. The Agreement increases the size of Palau's trust fund directly and indirectly to bolster the likelihood that the trust fund will yield payments of up to \$15 million annually through 2044. First, the United States will contribute \$3 million annually from 2013 through 2022 and contribute \$250,000 in 2023. Second, the

Government of Palau will delay withdrawals from the fund, drawing \$5 million annually through 2013 and gradually increasing its withdrawal ceiling from \$5.25 million in 2014 to \$13 million in 2023. From 2024 through 2044, Palau is expected to withdraw up to \$15 million annually, as originally scheduled. Under the Agreement, withdrawals from the trust fund may only be used for education, health, administration of justice and public safety.

RECOMMENDED CHANGES

We recommend several changes to the bill.

At present, the subsidy for the United States Postal Service (USPS) is a partial subsidy for domestic postage. The Agreement permits the USPS, under certain conditions, to impose international postal rates in the future. A subsidy would still be necessary in that event. Thus, in the amending language we recommend striking the language “so long as domestic postage may be used for mail to Palau, the Federated States of Micronesia, and the Marshall Islands” from the second sentence of subsection 105(e).

Additionally, in order to facilitate financing of the agreement we would recommend including the following language in the bill:

FUNDING FOR CERTAIN PROVISIONS UNDER SECTION 105 OF COMPACT OF FREE ASSOCIATION.—On the date of enactment of this section, out of any funds in the Treasury not otherwise appropriated, the Secretary of the Treasury shall transfer to the Secretary of the Interior such sums as are necessary for the Secretary of the Interior to implement sections 1, 2(a), 3, 4(a), and 5 of the Agreement, which sums shall remain available until expended without any further appropriation.

Furthermore, in the amending language that would insert a paragraph (2) of subsection 105(f), the Secretary of the Interior would be required to submit an annual report to committees of jurisdiction on the effectiveness of assistance to Palau under certain United States domestic programs. We recommend that the consultation provision be amended to require Federal agencies that administer such programs to submit annually to the Secretary of the Interior appropriate material ready for inclusion in the reports.

CONTINUING COOPERATION

The United States and Palau will work cooperatively on economic reform. The Agreement requires the two governments to establish an advisory group to recommend economic, financial and management reforms. Palau is committed to adopting and implementing reforms. Palau will be judged on its progress in such reforms as the elimination of operating deficits, reduction in its annual budgets, reducing the number of government employees, implementing meaningful tax reform and reducing subsidies to public utilities.

Palau’s progress in implementing reforms will be addressed at annual bilateral economic consultations. If the government of the United States determines that Palau has not made significant progress on reforms, the United States may delay payment of economic assistance under the Agreement.

The Agreement also continues to provide Palau with access to other United States services and grant programs, including the United States Postal Service, the National Weather Service, and the Federal Aviation Administration. The Postal Service moves mail between the United States and Palau, and offers other related services. Palau maintains its own postal service for internal mail delivery. The National Weather Service reimburses Palau for the cost of operating its weather station in Palau, which performs upper air observations twice daily, as requested, for the purpose of Palau’s airport operations and the tracking of cyclones that may affect other United States territories, such as Guam. The Federal Aviation Administration provides aviation services to Palau, including en-route air traffic control from the mainland United States, flight inspection of airport navigation aids, and other services.

The proposed legislation will also allow the continuance of other Federal program services currently available to Palau under separate authorizing legislation, including programs of the Departments of Education and Health and Human Services. The general authorization for Palau to receive such services was created by the Compact, but individual program eligibility has been created by specific laws that include Palau as an eligible recipient.

OFFSETS

The Palau Compact legislative proposal does have PAYGO costs. In the past, the Administration proposed a number of offsets to fund the Palau legislation, including:

- Net Receipt Sharing, which takes into account the costs of managing Federal oil and gas leases before revenues are shared with the States;
- Terminate payments for reclaiming abandoned coal mines to states that are already certified as having cleaned up all of their priority sites; and
- Production incentive fees on non-producing Federal oil and gas leases.

Each example by itself could provide more than enough savings to offset the costs of the Palau Compact. Net Receipt Sharing, for example, which has been enacted for five years through annual appropriations language, would be more than sufficient to offset the cost.

H.R. 6040 would provide for an offset to fund the Palau agreement. The Administration is still reviewing the specific language of that provision.

The Administration looks forward to continuing the United States partnership with Palau. The Department of the Interior is proud of the positive advancements United States assistance has achieved in Palau since 1995 and looks forward to the progress that we anticipate will be made over the period of the new agreement.

H.R. 6147

The Exclusive Economic Zone (EEZ) of the United States is a zone contiguous to the territorial sea of the United States, which generally extends 200 nautical miles from the U.S. coast line, unless it would extend into or overlap with a 200 EEZ of an adjacent nation. The EEZ applies to waters adjacent to the United States, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands (consistent with the Covenant and UN Trusteeship Agreement), and United States territories and possessions. The U.S. EEZ is the largest in the world, spanning over 13,000 miles of coastline and containing 3.4 million square nautical miles of ocean—larger than the combined land area of all fifty states.

The 200 nautical mile EEZ was established by President Reagan through Proclamation 5030 of March 10, 1983, which affirmed that within the EEZ, the U.S. had sovereign rights for the purpose of exploring, exploiting, conserving and managing natural resources, whether living and nonliving, of the seabed and subsoil and the superjacent waters and with regard to other activities for the economic exploitation and exploration of the zone, such as the production of energy from the water, currents and winds. The Proclamation also affirmed that the U.S. had jurisdiction as provided for in international law with regard to the establishment and use of artificial islands, installations, and structures, marine scientific research, and the protection and preservation of the marine environment, and other rights and duties provided for under international law. Many government agencies, including the Department of the Interior and its bureaus, carry out functions in the EEZ.

H.R. 6147 would designate the EEZ as the “Ronald Wilson Reagan Exclusive Economic Zone of the United States”. The bill would deem any reference to the EEZ in a law, map regulation, document, paper, or other record of the United States to be a reference to the “Ronald Wilson Reagan Exclusive Economic Zone of the United States”. Although the geographical range of the EEZ is relevant to certain elements of the Department’s jurisdiction, the naming of the EEZ does not affect any of the Department’s existing authorities or programs. The Department notes that it is not aware of any precedence for a designation of this type. Therefore, the Department takes no position on H.R. 6147.

Dr. FLEMING. Next, Mr. Kagan, you have 5 minutes, sir.

STATEMENT OF HON. EDWARD D. KAGAN, DEPUTY ASSISTANT SECRETARY, BUREAU OF EAST ASIAN AND PACIFIC AFFAIRS, U.S. DEPARTMENT OF STATE

Mr. KAGAN. Mr. Chairman, Ranking Member Sablan and members of the Subcommittee, thank you very much for inviting me to appear before you today to testify on our important bilateral relationship with Palau. We are grateful for the sustained bipartisan commitment to the Compact and to that relationship. As a valuable contribution to this process made so far by Members of Congress—

Dr. FLEMING. Excuse me just a moment. We are not able to hear you, is the mic close enough to your mouth?

Mr. KAGAN. Sorry about that.

Dr. FLEMING. Always an easy mistake to make. So thank you.

Mr. KAGAN. We are grateful for the sustained bipartisan commitment to the Compact and to the relationship with Palau, and particularly to the valuable contribution to this process made so far by Members of Congress, including leadership of several key Committees. And although we have concerns about some of the specific provisions in H.R. 6040, we hope the Compact legislation will be passed by Congress and signed by the President as soon as possible.

As you know, our relationship with Palau as well as with the rest of the Pacific Island nations is the key aspect of Administration's focus on expanding the scope and the pace of our engagement in the Asia-Pacific region. I just returned from accompanying Secretary Clinton to the Pacific Islands post forum dialog in the Cook Islands where I was grateful to be joined by my fellow witness, close colleague and good friend, Assistant Secretary Babauta.

Secretary Clinton's presence at the forum was the first by a Secretary of State in its 41-year history and highlighted our sustained commitment to enhancing our relationship with our Pacific partners, including Palau as part of our broader engagement with the Asia-Pacific region. While there, I met with Palau's Minister of Justice and other senior officials and they raised the status of this legislation, passage of which is their highest priority in working with the United States.

Mr. Chairman, as you know, the Pacific and the island countries that reside there are critical to our national security and are vital to our connection to the Asia-Pacific region. Among our many friends in the region, we have perhaps none closer than Palau, a country for which we paid a steep price to liberate in 1944.

In terms of our foreign policy interests, we have two critical tasks with Palau. First is to sustain our full and reinforce our full authority and responsibility for the security and defense of Palau. And the second is to continue to strengthen our close cooperation with Palau which helps support our common goals in everything from fisheries management to human rights to countering proliferation of weapons of mass destruction.

Under the Compact of Free Association, the United States provides for the security of Palau. The security relationship gives us access to Palau and its waters and the authority to deny such access by foreign military forces. The relatively modest annual cost associated with proposed legislation is leveraged many times over in the important strategic advantages this arrangement confers on the United States.

In addition, as you know, under the terms of the Compact, Palauans are eligible to serve in the U.S. Armed Forces and they volunteer at the U.S. Military at a rate higher than any individual U.S. State. We are very grateful for their dedication and honor their sacrifices.

Now Palau is, as you know, one of our closest friends and supporters. Palau is an ardent advocate for enhanced U.S. Engagement in the region and has been a very strong supporter at the United Nations. Palau's voting coincidence in the most recent U.N. General Assembly with the United States on all votes is approximately 97 percent, which is quite high.

Our partnership goes beyond defense, we work closely with Palau in the fight against international crime and terror and on other issues. And we are particularly grateful that in 2009, Palau accepted for temporary resettlement, six ethnic Uyghur detainees from Guantanamo when few other countries would.

As you know, our compact with Palau took effect in 1994. It does not have a termination date and requires a review on the 15-year, 30-year, and 40-year anniversaries. The direct economic assistance provisions expired in 2009, and our two governments have worked very closely over 20 months of discussions and negotiations to conclude the 15-year review which resulted in the agreement signed in September 2010. The legislation will implement the outcomes of the review, and is important to reflect the shared commitment of our two governments to our continued partnership.

I would note that there are some provisions in the current draft of H.R. 6040 that exceed the agreement reached between the United States and the Government of Palau by extending additional benefits and supplemental funding to Palau, which would run counter to the carefully calibrated goals of the Administration negotiating this agreement. We are prepared to work with the Subcommittee with interested Members to ensure legislation reflects the bilateral agreement reached during the Compact review.

Palau—it is crucial that we provide Palau the assistance agreed to in the Compact review, and as part of agreement, as you know, Palauans will be required to have machine readable passports to travel to the United States in the future. Palau has been a staunch ally and is essential that we stand by our commitments. The Palauan people have been loyal and dedicated partners. They share our interest in regional international security. Failing to implement the 15-year review of the Compact with Palau would undermine our national interests. And in today's dynamic Pacific environment, failure to live up to our commitments and to stand by our partners and longstanding friends would not go unnoticed. We believe it is strongly in the national interest to move quickly. We appreciate the interest and leadership of this Subcommittee in considering this legislation promptly and hope both the House and Senate will pass it as soon as possible.

Thank you again, Mr. Chairman, for giving me the opportunity to testify before you today and to clarify the importance of this legislation. I look forward to answering your questions.

Dr. FLEMING. Mr. Kagan, you came very close to the record of perfection on ending your testimony at the right moment there. We appreciate that.

Mr. KAGAN. Thank you.

[The prepared statement of Mr. Kagan follows:]

**Statement of Edgard D. Kagan Deputy Assistant Secretary of State,
Bureau of East Asian and Pacific Affairs, U.S. Department of State**

Chairman Fleming, Ranking Member Sablan, and Members of the Subcommittee, thank you for inviting me to appear before you today to testify on the importance of our bilateral relationship with Palau as well as to discuss the Compact with Palau and proposed legislation approving the results of the mandated 15-year Compact review. Although we are concerned about specific provisions in H.R. 6040, the Continued Free Association with Palau Act of 2012, we hope the Compact review legislation will be passed by the Congress and signed by the President as soon as possible.

Our relationship with Palau, as well as that with other Compact nations and independent states in the Pacific, is a key aspect of the Administration's focus on expanding the scope and pace of our engagement with the Asia-Pacific region, and specifically on ensuring that we increase our engagement with Pacific Island nations as we look forward to what the President has called the "Pacific Century." I was fortunate during the first few weeks in my current position to be able to travel with Assistant Secretary for East Asian and Pacific Affairs Kurt Campbell to the region, including to Palau. My visit to Palau demonstrated to me the excellent relationship we enjoy with the people of Palau and President Toribiong. I just returned from accompanying Secretary Clinton to the Pacific Islands Forum Post-Forum Dialogue and participating in the latest round of Tuna Treaty negotiations in Vanuatu. Secretary Clinton's presence at the Pacific Islands Forum was the first by a Secretary of State in its 41-year history and marked a historic level of effort and attention being paid by the Administration to working with our Pacific partners, including Palau, to address many of the problems they are facing. I was able to meet with Palau's Minister of Justice and other senior officials, and they raised the status of the legislation, passage of which is their highest priority in working with the United States.

Palau Remains a Friend and Reliable Partner

Mr. Chairman, the vast stretch of the Pacific and the island countries that reside within it share an integral connection to our western border and are critical to our national security. Linking many of our close friends and allies, from Japan and Australia to Palau, Papua New Guinea, and Tonga, the Pacific region forms a crucial security arc that stretches from California to the Philippines, from Alaska to New Zealand. Our presence and ties to our partners in the Pacific not only safeguard our security interests, they also guarantee access to the critical sea lanes through which much of our trade flows. Among our many friends and partners in the region, we have perhaps none stronger than Palau, a country for which we paid a steep price in blood and treasure to liberate in 1944.

Our relations with our Pacific partners are unfolding against the backdrop of a shifting strategic environment, where emerging powers in Asia and elsewhere seek to exert a greater influence in the Pacific region, through development aid, people-to-people contacts, and security cooperation. There is greater uncertainty in the region about the United States' willingness and ability to sustain the robust forward presence in the Pacific that has been a hallmark of much of the 20th century. That is why the Administration is putting such an effort into increasing our engagement not only with mainland and maritime Asia, but with the Pacific as well.

With respect to our foreign policy goals in the region, I think we have two critical tasks that touch on our historic relationship with Palau. First, we have to sustain and reinforce our full authority and responsibility for the security and defense of Palau. We have no greater responsibility in the eyes of the Palauan people, and I know that we, and the other federal agencies that work with Palau, take that responsibility very seriously. Second, we have to ensure that our partners in the Pacific, including Palau, continue to work with us and support our common goals in regional and multilateral fora, on everything from fisheries management to human rights to countering the proliferation of weapons of mass destruction.

Under the Compact of Free Association, the United States provides for the security of Palau, which occupies a strategic position in the Western Pacific. This security relationship gives us access to Palau and its waters, along with the critical authority to deny such access by military forces and personnel of other nations. While we have welcomed for many decades a peaceful and positive approach to relations in the Pacific by all parties, the relatively modest annual cost associated with the proposed legislation is leveraged many times over in the important strategic advantages this arrangement confers on the United States.

As a result of our security guarantee, Palau does not maintain its own military forces, but under the terms of our Compacts, their citizens are eligible to, and do, serve voluntarily in the U.S. Armed Forces. Palauan citizens volunteer in the U.S. military at a rate higher than in any individual U.S. state. Approximately 500 Palauan men and women serve in our military today, out of a population of about 14,000. We are grateful for their sacrifices and dedication to promoting peace and fighting terrorism. Palau has deployed soldiers for U.S. coalition missions and participated in U.S.-led combat operations in the world's most difficult and dangerous places, including Afghanistan and Iraq, where several Palauans have lost their lives in combat.

President Toribiong's niece and Minister Jackson Ngiraingas' son both serve in the U.S. Navy. The son of Minoru Ueki, Palau's Ambassador to Japan, serves in the U.S. Army. Palau Paramount Chief Reklai has a daughter and son in the Army.

Palau's Ambassador to the United States, Hersey Kyota, has two adult children serving in the Armed Forces. He has several nephews serving in the Army and Marine Corps. Similarly, many other Palauan sons and daughters of other government officials and of ordinary Palauan citizens served honorably in U.S. military units since the Compact has been in place, most recently in Afghanistan and Iraq.

In addition to our specific responsibility for the safety and security of the Palauan people under the Compact, given the wide range of U.S. strategic interests and equities in the Western Pacific, security developments in the region require our sustained presence and engagement. The Reagan Ballistic Missile Defense Test Site on Kwajalein Atoll, the presence of U.S. Armed Forces, including the U.S. Coast Guard, in Guam and in the waters of the Pacific, and our disaster relief operations throughout the region are all crucial to peace and security not only for the region, but for the United States. Keeping our commitments to Palau, as reflected in the proposed legislation, reinforces our defense posture in the Western Pacific, and therefore our strategic interests. Access to Palauan waters, lands, airspace, and its Exclusive Economic Zones (EEZ), grants us economic benefits and allows us to guard and protect our long-term defense interests in the region.

With respect to the second goal of maintaining and strengthening our relationship, Palau is among our strongest supporters in regional and multilateral fora. In the former, Palau has been an ardent advocate for enhanced U.S. participation and engagement in the Pacific Islands Forum and a constructive partner as we work to extend the South Pacific Tuna Treaty.

At the 66th General Assembly of the United Nations, Palau's voting coincidence with the United States on all votes is approximately 97 percent, which is markedly higher than 80 percent for the United Kingdom, 88 percent for Australia, and 70 percent for both Japan and South Korea. Despite an increase in assistance from others interested in enhancing their engagement with the region, such as China, Russia, and the Arab League nations, Palau has not only supported the United States' on Israel and Cuba-related votes but has been at the forefront of actively helping garner the support of others. Palau has supported UN resolutions seeking to combat the spread of weapons of mass destruction, and joined in efforts to address systematic human rights abuses in North Korea, Syria, and Iran.

Our Partnership Extends Beyond Defense

The importance of our strong relationship with Palau is not limited to defense. We work closely with Palau in the fight against international crime and terror. In 2009, Palau resettled six ethnic Uighur detainees from Guantanamo when few other countries would. Palau was our first island partner to sign the U.S. ship rider and ship-boarding agreements that are successfully increasing maritime surveillance and law enforcement cooperation in the Pacific Islands.

Palau is a key and constructive player in helping set the tone of our negotiations with 16 Pacific Island nations on the extension of our South Pacific Tuna Treaty. This treaty guarantees access to South Pacific waters to our tuna fleet in return for specific obligations in terms of environmental regulation, conservation measures, and other important efforts to sustain the viability of South Pacific tuna stocks long-term. The value of this treaty to the United States has averaged more than \$360 million a year over the past three years, and I am glad to report that we have made significant progress toward reaching an agreement that will ensure that access, and the support for thousands of tuna industry jobs here in the United States and American Samoa, for some time to come.

Our people-to-people connections continue to grow strong. Since 1966, more than 4,200 Peace Corps Volunteers have served in Palau, teaching English and life skills and supporting economic development, education, capacity building, and marine and terrestrial resource conservation in Palau and in the two other Freely Associated States. Today approximately 55 Peace Corps volunteers serve in Micronesia and Palau.

Responsibility as a Compact Partner

The original process that led to our Compact with Palau was based on a solemn promise to help this young nation through financial, security, and other assistance to achieve self-governance and a sustainable economic development path. The effort that has gone into the 15-year Compact review, and the positive contribution of Members of both Houses of Congress to work towards implementing those arrangements is a symbol of our good faith and partnership, not just in Palau, but also among all our Pacific partners.

The timing of this review could not be more important. We are now at a point where the goal of self-governance and democracy in Palau is firmly in place. The goal of sustainable economic development and independence, however, remains a

work in progress. The tiered nature of the support agreed to in this 15-year review is designed to reduce Palau's dependence on U.S. direct economic assistance and assist Palau in moving towards sustainable economic development. Importantly, it also requires the Palauan government to undertake serious economic and fiscal reforms, and, should the United States determine that progress towards such reform is inadequate, we are able to withhold further assistance until they are implemented.

Our Compact with Palau took effect in 1994. It does not have a termination date and requires a review on the 15-year, 30-year, and 40-year anniversaries. The direct economic assistance provisions of the Compact, however, expired on September 30, 2009. Our two governments worked closely over 20 months of discussions and negotiations to conclude the 15-year review, which resulted in an Agreement signed by former Deputy Assistant Secretary Frankie Reed and President Toribiong in September 2010. The legislation will implement the outcomes of the review and is the manifestation of the shared commitment between our two governments. I would note, however, that the provisions in the current draft of H.R. 6040 exceed the agreement reached between the United States and the Government of Palau by extending additional benefits and supplemental funding to Palau, which would run counter to the carefully calibrated goals of the Administration in negotiating the agreement. We are prepared to work with this Subcommittee and with interested Members to ensure that the legislation reflects the bilateral agreement reached during the Compact review.

Those provisions notwithstanding, the proposed Compact Review legislation would amend Title I of Public Law 99-658 regarding the Compact of Free Association between the Government of the United States of America and the Government of Palau. In formal language, this bill would approve the results of the 15-year review of the Compact, including the Agreement between our two governments following the Compact of Free Association Section 432 Review.

The assistance package within the Agreement is designed to relieve Palau from its dependence upon U.S. direct economic assistance as it continues to grow and reform its economy. The Agreement provides a glide path for Palau to move from reliance on the over \$18 million it has been receiving to a sustainable \$15 million level, provides for U.S. contributions to the Trust Fund from FY 2013 through FY 2023 and decreases the amount Palau may withdraw from the Trust Fund during this period, to allow the Trust Fund to grow. The terms of the agreement also commit Palau to a range of economic reforms designed to help increase fiscal transparency, combat corruption, and create a stronger foundation for economic sufficiency in the future. If the United States determines that insufficient progress has been made on economic reform, we may delay assistance payments until we deem sufficient progress has been made. The Agreement has other provisions that supplement the Compact, resulting from a review of how the Compact worked over its first 15 years. For example, Palau will continue to be eligible for a wide range of federal programs and services from agencies such as the U.S. Postal Service, federal weather services, the Federal Aviation Administration, the Department of Agriculture, and Health and Human Services. The Agreement will also require Palauan nationals coming to the United States under the Compact to have machine readable passports (instead of allowing them to come to the United States without passports).

If the bilateral Agreement between our two countries is not implemented, the trust fund would be unable to provide a steady outlay of \$15 million per year, from now until 2044, which was the intended purpose of the Compact negotiators in the 1980s. To ensure smooth continuation of our bilateral relationship as well as the continued economic development and advance of its self sufficiency, it is crucial we provide Palau the assistance agreed to in the Compact review.

Supporting Palau's Transition to Independence

Our history with Palau began in bloody battle in 1944. It was a sense of duty, and the understanding that Palau was important to our strategy in the Pacific, that led thousands of Marines ashore to free Palau from colonialism and occupation. Palau remains important now, and that same duty has led the United States down a long road of partnership with the people of Palau from liberation to trusteeship and, finally, to independence. That steadfast commitment to our friends has been noted not just in Palau, but across the Pacific.

Shortly after the end of World War II, the United Nations assigned the United States administering authority over the Trust Territory of the Pacific Islands, which included Palau and island districts of Micronesia that we had liberated from Japanese occupation. Palau adopted its own constitution in 1981, and the governments of the United States and Palau concluded a Compact of Free Association that entered into force on October 1, 1994.

With a government modeled on our own, Palau shares our goals for human rights and democracy throughout the world. Palau has shown maturity of a much older nation in its democratic processes, which is a testament to the commitment to strong values the people of the Pacific have, and reinforces the value of the Compact as a vehicle for transition.

Palau has been a staunch ally to the United States, and it is essential we stand by our commitment to the people of Palau. The Palauan people have been loyal and dedicated partners, but they are concerned about their future and that of their grandchildren. Palau is as interested in regional and international security as we are. Failing to affirm the results of the 15-year review of the Compact with Palau is not in our national interest. We appreciate the interest and leadership of this Subcommittee in considering this legislation promptly and hope both the House and the Senate will pass it as quickly as possible.

As the generation for which the Second World War was a defining experience passes and other emerging powers seek to increase their influence in the region, passage of this legislation will send a reassuring signal that the United States is and will be engaged in the Pacific and will remain a faithful friend and ally through both good and challenging times.

The Importance of Implementing the Agreement

Mr. Chairman, the President, Secretary Clinton, and others in this Administration deeply appreciate not only the rich and historic World War II legacy of the Pacific, but also the continuing strategic role those islands and waters play globally. The Administration places great importance on continuing our strong alliance with Pacific Island partners. I recently visited the battlefield of Peleliu, where more than 3,000 U.S. Marines were lost liberating the island, a necessary step towards the eventual liberation of the Philippines and the seizure of other key island bases that helped bring the war to a close. I met with Palauans who are working with partners in the United States to identify personal effects that still remain on the battlefield and to return them to family members in the United States nearly seventy years later. These efforts are emblematic of our shared history and the deep connections that have been forged in the decades since World War II. In the current political environment in the Pacific region, it is paramount that we maintain those ties and continue to develop our strategic framework for a peaceful future in the region. Our investment will help to ensure that Palau becomes financially independent over time and continues to stand with us as a loyal, trustworthy, and democratic ally.

If the Agreement is not implemented, Palau will not have had time to adjust to the reduction from \$18 million to \$15 million in combined direct assistance and trust fund withdrawals on which it has been relying and will not have embarked on the reforms called for in the September 2010 agreement. Palau's economy would suffer a serious blow from the \$3 million reduction in assistance (between direct assistance and trust fund withdrawals), which would seriously damage our bilateral relationship in a key region of the world. In today's dynamic Pacific environment, our inability to stand by our partners would not go unnoticed, and it is likely that Palau would face offers of assistance from other nations expanding their reach in the Pacific to fill the void we would leave.

I hope that my testimony today gives you an understanding and sense of how the Compact deepens our partnership with Palau and serves the interests of the United States. I look forward to working with you and other Members of Congress to secure and advance U.S. interests in Palau by passing the legislation implementing the results of the Compact review.

Thank you again for giving me the opportunity to testify before you today and to clarify the importance of this legislation. I look forward to answering your questions.

Dr. FLEMING. Next, we have Mr. Gootnick. Sir, you have 5 minutes.

STATEMENT OF DAVID GOOTNICK, DIRECTOR, INTERNATIONAL AFFAIRS AND TRADE, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. GOOTNICK. Thank you, Mr. Chairman. Mr. Chairman and members of the Subcommittee, thank you for asking GAO to participate in this hearing. As has been stated, the 1994 Compact provided 15 years of economic assistance, established the trust fund, built the compact road, and provided for postal, weather and avia-

tion services. Importantly, the Compact also established the basis for discretionary Federal programs such as Head Start, community health centers, Pell Grants, airport improvements, special education and numerous others. Taken together since 1994, the Compact and U.S. programs are valued at more than \$850 million, of which U.S. program assistance was about one-third.

My statement which I will briefly summarize describes one, the economic provisions of the agreement; two, the impact of the agreement on Palau's trust fund; three, projected Palau government revenues under the agreement. In the statement, we have also provided some descriptive information on 6040 and 343 which we can discuss.

As has been stated the agreement would provide \$215 million in assistance with a steady annual decrement from roughly \$28 million to \$2 million in 2024. One hundred seven million, roughly half of the assistance would support government operations. The agreement also provides \$40 million for infrastructure projects, \$28 million for the maintenance fund, \$10 million to debt relief and adds \$30 million to the trust fund.

Importantly the agreement extends postal, weather and aviation, and the authority to continue discretionary Federal programs. The agreement puts certain conditions on the \$215 million package. For example, economic assistance is directed to specific sectors such as health, education and public safety. Also under the agreement, an advisory group would be appointed and tasked to make recommendations for fiscal and management reforms. And the U.S. made to lay funding condition on the progress of these reforms.

For the infrastructure fund, projects must have land title and a certified scope of work to get funding, and the maintenance fund is primarily for U.S. finance projects, in particular, the Compact road and the international airport.

Debt relief prioritizes U.S. creditors and requires U.S. concurrence on debts to be paid. Regarding the trust fund, the proposed U.S. contributions and the delay in schedule withdrawals would markedly improve the fund's prospects. In 2009, we reported that the trust fund would require an annual return above 10 percent to yield its proposed schedule through 2044. However, under this agreement, the trust fund would need only a 5 percent return to yield its new schedule withdrawals. This is well below the nearly 8 percent it has earned to date.

Last, to offset the steady decline in budget support through 2024, estimates prepared for the Government of Palau project a growing reliance on trust fund withdrawals and domestic revenue as well as steady access to U.S. Federal programs. Specifically the estimates project a steep rise in domestic revenue, growing from roughly 40 to nearly 60 percent of government revenue by 2024, and the estimates project that discretionary Federal programs will grow at roughly the rate of inflation. They are projected at half of all U.S. assistance over the next 15 years. As you know, unlike other components of this agreement these programs depend on annual appropriations.

In summary, Mr. Chairman, the economic provisions of the agreement extend and gradually reduce compact assistance through 2024, establish new conditions for the use of U.S. funds,

and reset the trust fund to significantly improve its long-term prospects. Palau has employed projections of its long-term fiscal conditions that rely on increased revenue and the continuation of U.S. Federal programs.

Mr. Chairman, this completes my remarks ahead of schedule, and I am happy to answer any questions.

Dr. FLEMING. Thank you, Mr. Gootnick, both for your testimony and for ending it early. We thank you for that.

[The prepared statement of Mr. Gootnick follows:]

**Statement of David Gootnick, Director, International Affairs and Trade,
U.S. Government Accountability Office (GAO)**

Chairman Fleming, Ranking Member Sablan, and Members of the Subcommittee: I am pleased to be here today to discuss the September 2010 agreement between the U.S. and Palau governments.¹

The Compact of Free Association between the Government of the United States and the Government of the Republic of Palau, which entered into force in 1994,² provided for several types of assistance aimed at promoting Palau's economic advancement and eventual self-sufficiency.³ In addition to establishing Palauan sovereignty and U.S.-Palau security and defense arrangements, the compact provided economic assistance to Palau.⁴ This assistance comprised, among other things, direct economic assistance for 15 years to the Palau government; the establishment of a trust fund intended to provide Palau \$15 million annually from 2010 through 2044; investments in infrastructure, including a major road; and the provision of federal services, such as postal, weather, and aviation. The compact also established a basis for U.S. agencies to provide discretionary federal programs related to health, education, and infrastructure. In June 2008, we projected that U.S. assistance to Palau from 1995 through 2009 would exceed \$852 million, with assistance under the compact accounting for about 68 percent and assistance through discretionary programs accounting for about 31 percent.⁵ We also reported in 2008 that the likelihood of the Palau trust fund's being able to sustain the planned payments through 2044 was uncertain.

The September 2010 agreement between the U.S. and Palau governments (the Agreement) followed a formal review of the compact's terms required 15 years after the compact entered into force.⁶ Provisions of the Agreement would, among other things, extend economic assistance to Palau beyond the original 15 years and modify trust fund arrangements. The Agreement establishes an assistance schedule beginning in 2011. There are currently two bills pending before the Congress to approve and implement the Agreement. A bill now pending before the U.S. Senate would approve the Agreement and also appropriate funds to implement it.⁷ However, the

¹ *The Agreement between the Government of the United States of America and the Government of the Republic of Palau Following the Compact of Free Association Section 432 Review* (Sept. 3, 2010).

² *The Compact of Free Association between the Government of the United States of America and the Government of the Republic of Palau* (Oct. 1, 1994).

³ See Proclamation 6726, *Placing into Full Force and Effect the Compact of Free Association with the Republic of Palau*, 59 Fed. Reg. 49777 (Sept. 27, 1994). Congress approved the Compact of Free Association in Public Law 99-658 on November 14, 1986, and Public Law 101-219 on December 12, 1989. The grant funds specified by the compact are backed by the full faith and credit of the U.S. government.

⁴ Unless otherwise noted, all years cited are fiscal years (Oct. 1–Sept. 30). In addition, all dollar amounts in this report are in nominal dollars (i.e., unadjusted for inflation).

⁵ GAO, *Compact of Free Association: Palau's Use of and Accountability for U.S. Assistance and Prospects for Economic Self-Sufficiency*, GAO-08-732 (Washington, D.C.: June 10, 2008).

⁶ Section 432 of the compact provides for the U.S. and Palau governments to formally review the terms of the compact and its related agreements and to consider the overall nature and development of their relationship, on the 15th, 30th, and 40th anniversaries of the compact's effective date. The governments are to consider the operating requirements of the Government of Palau and its progress in meeting the development objectives set forth in section 231(a) of the compact. The terms of the compact shall remain in force until otherwise amended or terminated pursuant to title four of the compact.

⁷ Senate Bill 343, as introduced in the Senate, amends Title I of Public Law 99-658; approves the results of the 15-year review of the compact, including the Agreement; and appropriates funds for the purposes of the amended Public Law 99-658 for fiscal years ending on or before September 30, 2024, to carry out the agreements resulting from the review. S. 343, 112th Cong. (2011).

Senate bill does not reflect the fact that fiscal year 2011 has passed.⁸ A bill now pending before the House would approve the agreement, apply an inflation adjustment to assistance payments, and shift the timing of certain assistance payments to reflect the passage of fiscal year 2011.⁹

The Senate Committee on Energy and National Resources held a hearing to review the pending bill on June 16, 2011; the Subcommittee on Asia and the Pacific of the House Committee on Foreign Affairs held a hearing to assess the formal review and proposed Agreement on November 30, 2011. We testified at both hearings and described the terms of the Agreement, assessed trust fund balances and disbursement plans under various assumptions and investment returns, and examined single audit reports and budget estimates prepared for the Palau government.¹⁰

My statement today updates our November 2011 statement.¹¹ In particular, it describes (1) the extension of economic assistance to Palau as outlined in the Agreement, (2) the impact that this assistance would have on the Palau trust fund's sustainability, (3) the projected role of U.S. assistance in Palau government revenues, and (4) the pending legislation to implement the Agreement. We used recent data from the Palau trust fund to update its sustainability, and we reviewed the bill pending before the House that was introduced in July 2012.¹² In addition, since Congress has not approved legislation implementing the agreement, we note that the Department of the Interior has provided direct economic assistance to Palau. We conducted this work from August and September 2012 in accordance with all sections of GAO's Quality Assurance Framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our stated objectives and to discuss any limitations in our work. We believe that the information and data obtained, and the analysis we conducted, provide a reasonable basis for any findings and conclusions in this product.

Background

Palau consists of 8 main islands and more than 250 smaller islands, with a total land area of roughly 190 square miles, located approximately 500 miles southeast of the Philippines. About 20,000 people live in Palau, concentrated largely in one urban center around the city of Koror, and more than one-quarter of the population is non-Palauan.¹³ Palau's economy is heavily dependent on its tourism sector and on foreign aid from the United States, Japan, and Taiwan.¹⁴ Similar to many small island economies, Palau's public sector spending represents a significant percentage of its gross domestic product (GDP).¹⁵

U.S. relations with Palau began when American forces liberated the islands near the end of World War II. In 1947, the United Nations assigned the United States administering authority over the Trust Territory of the Pacific Islands, which included what are now the Federated States of Micronesia, the Republic of the Marshall Islands, the Commonwealth of the Northern Mariana Islands, and Palau. Palau adopted its own constitution in 1981. The U.S. and Palau governments concluded a Compact of Free Association in 1986; the compact entered into force on October 1, 1994. The Department of the Interior's (Interior) Office of Insular Affairs (OIA) has primary responsibility for monitoring and coordinating all U.S. assistance to Palau, and the Department of State (State) is responsible for government-to-government relations.

⁸S. 343, as introduced in the Senate.

⁹House Bill 6040, as introduced in the House, amends Title I of Public Law 99-658; approves the results of the 15-year review of the compact, including the Agreement; shifts the schedule of certain assistance payments; creates an annual reporting requirement for the Department of the Interior; and includes an offset provision. H.R. 6040, 112th Cong. (2012).

¹⁰GAO, *Compact of Free Association: Proposed U.S. Assistance to Palau and Its Likely Impact*, GAO-11-559T (Washington, D.C.: June 16, 2011).

¹¹GAO, *Compact of Free Association: Proposed U.S. Assistance to Palau for Fiscal Years 2011-2024*, GAO-12-249T (Washington, D.C.: Nov. 30, 2011).

¹²H.R. 6040.

¹³Palau's private sector relies heavily on foreign workers, mostly from the Philippines. We reported in 2008 that since 1994, foreign workers, as registered with Palau's Social Security Office, had grown to account for half of Palau's total labor force. Because many of these foreign workers send wage income back to their home nations, in 2005 the annual net outflow of remittances from Palau equaled an estimated 5.5 percent of its gross domestic product (GDP).

¹⁴The International Monetary Fund (IMF) projected that in 2010, Palau's GDP was an estimated \$218 million and reported that Palau's GDP per capita was about \$10,500. Business and tourist arrivals were projected to be 78,000 in 2010. See IMF, *Republic of Palau Staff Report for the Article IV Consultation* (Apr. 12, 2010).

¹⁵According to the IMF, in 2010, Palau's public sector spending was projected at approximately 42 percent of its GDP.

Key provisions of the compact and its subsidiary agreements address the sovereignty of Palau, types and amounts of U.S. assistance, security and defense authorities, and periodic reviews of compact terms. Table 1 summarizes key provisions of the Palau compact and related subsidiary agreements.

Table 1: Key Provisions of Palau Compact of Free Association and Subsidiary Agreements

Compact section	Description of key provisions
Title one: Government Relations	<i>Sovereignty</i> Established Palau as a self-governing nation with the capacity to conduct its own foreign affairs.
	<i>Immigration privileges</i> Provided Palauan citizens with certain immigration privileges, such as the rights to work and live in the United States indefinitely and to enter the United States without a visa or passport. This privilege remains in effect as long as the compact agreement is not amended by mutual agreement or mutually or unilaterally terminated.
Title two: Economic Relations	<i>Compact direct assistance</i> Established 15-year term of budgetary support for Palau, beginning on compact's effective date. This support included direct assistance for current account operations and maintenance and for specific needs such as energy production, capital improvement projects, health, and education.
	<i>Trust fund</i> Required the United States to contribute to a trust fund for Palau.
	<i>Compact Road</i> Required the United States to construct a road system (the Compact Road). ^a
	<i>Compact federal services</i> Required the United States to make available certain federal services and related programs to Palau, such as postal, weather, and aviation. The compact subsidiary agreement implementing such services was in force until October 1, 2009. ^b
	<i>Accountability for compact funds</i> Required Palau to report on its use of compact funds and required the U.S. government, in consultation with Palau, to implement procedures for periodic audits of all grants and other assistance. ^c
Title three: Security and Defense Relations	<i>U.S. authority for security and defense matters</i> Established that the United States has full authority and responsibility for security and defense matters in or relating to Palau, would take action to meet the danger of an attack on Palau, and may conduct activities on land, water, and airspace as necessary.
	<i>Strategic denial</i> Foreclosed Palau to the military of any nation except the United States, unless they are invited by the United States and under the control of the U. S. armed forces.
	<i>U.S. defense sites and operating rights</i> Established that the United States may establish land and sea defense sites in Palau and has certain military operating rights. The subsidiary agreement implementing this provision provides the United States exclusive use of certain land adjoining the airport and certain submerged land in Malakal Harbor and remains in effect through 2044.
	<i>Service in the armed forces</i> Established eligibility of Palau citizens to serve in the U.S. armed forces.
	The provisions on U.S. authority for security and defense matters, U.S. defense sites and operating rights, and service in the armed forces remain in effect unless the compact is terminated by mutual agreement or, if the compact is unilaterally terminated, until October 1, 2044, and thereafter as mutually agreed. The strategic denial provision remains in effect through 2044 and thereafter until terminated or otherwise amended by mutual consent.
<hr/>	
Compact section	Description of key provisions
Title four: General Provisions	Established general provisions regarding approval and effective date of the compact, conference and dispute resolution procedures, and compact termination procedures. Required reviews of its terms on the 15th, 30th, and 40th anniversaries of the compact's entry into force—that is, in 2009, 2024, and 2034, respectively.

Source: GAO analysis of the Compact of Free Association between the Government of the United States and the Government of the Republic of Palau.

Notes:

The compact's subsidiary agreements relate to specific titles of the compact and, in many cases, contain implementing details of compact provisions.

Years are fiscal (Oct. 1–Sept. 30).

^aThe compact called for the United States to build the Compact Road according to mutually agreed specifications before October 1, 2000. The road was completed and turned over to Palau on October 1, 2007. See GAO-08-732, appendix V, for more information.

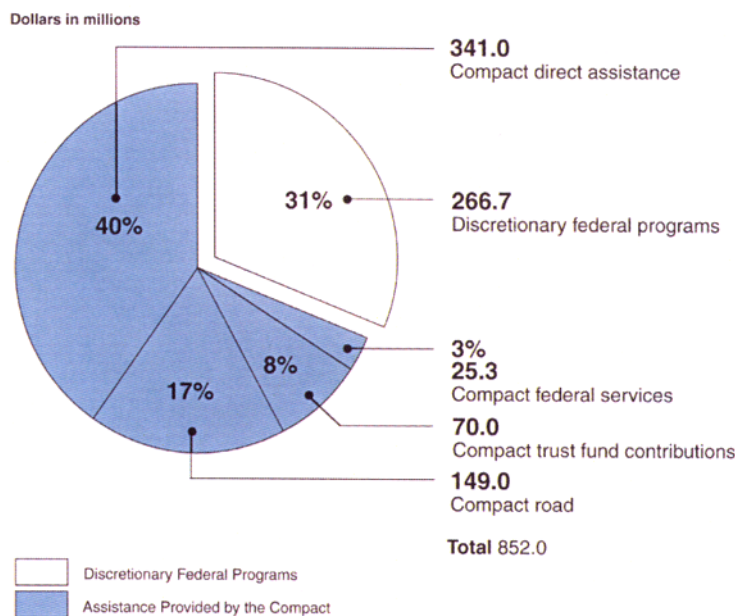
^bFederal Programs and Services Agreement Concluded Pursuant to Article II of Title Two and Section 232 of the Compact of Free Association, which took effect in 1995, established the legal status of programs and related services, federal agencies, U.S. contractors, and personnel of U.S. agencies implementing both compact federal services and discretionary federal programs in Palau. Under this agreement, the United States Postal Service (USPS) conveys mail between the United States and Palau and offers other services such as Priority Mail®, Collect on Delivery, and USPS Domestic Money Orders. Palau maintains its own postal service for internal mail delivery. Under this agreement, the National Weather Service reimburses Palau for the cost of operating its weather station in Palau, which performs upper air observations twice daily and as requested for the purpose of Palau's airport operations and the tracking of cyclones that may impact other U.S. territories such as Guam; and the Federal Aviation Administration provides aviation services to Palau, including en-route air traffic control from the mainland United States, flight inspection of airport navigation aids, and technical assistance and training.

^cIn August 2012, the government of Palau submitted its annual single audit for fiscal year 2010 that was due in June 2011; however, the government of Palau has not yet submitted its annual single audit for fiscal year 2011 that was due in June 2012.

In addition to the U.S. assistance provided under the compact, U.S. agencies—the Department of Education, the Department of Health and Human Services (HHS), and Interior, among others—provide discretionary federal programs in Palau as authorized by U.S. legislation¹⁶ and with appropriations from Congress. (See app. II for a complete listing of these programs in Palau.)

In our 2008 report, we projected that U.S. assistance to Palau from 1995 through 2009 would exceed \$852 million. Of this total, economic assistance under the compact accounts for a projected 68 percent and discretionary federal programs account for a projected 31 percent (see fig. 1).¹⁷

Figure 1: U.S. Assistance to Palau in 1995-2009 as Projected in 2008



Source: GAO analysis.

Notes:

Years are fiscal (Oct. 1-Sept. 30), and dollar amounts are in nominal dollars (i.e., unadjusted for inflation).

Percentages may not sum to 100 because of rounding.

Amounts shown for compact direct assistance, compact trust fund contributions, and the Compact Road are based on Interior's Office of Insular Affairs' actual and estimated payments to Palau for 1995-2009, as reported in Interior's budget justification to Congress for 2009.

Amount shown for compact federal services is based on GAO estimates of past expenditures by the National Weather Service, U.S. Postal Service, and Federal Aviation Administration.

Amount shown for estimated discretionary federal programs is the sum of (1) U.S. agency program expenditures as reported in single audits for 1995-2006 for the Palau national government and for 1997-2006 for the Palau Community Action Agency and the Palau Community College, (2) GAO estimates of U.S. agency program expenditures for 2007-2009, and (3) GAO estimates of DOD Civic Action Team costs for 1995-2009. Estimated and projected federal program expenditures do not include the value of U.S. loans to Palau. For more information, see [GAO-08-732](#).

¹⁶The compact's federal programs and services agreement, establishing the legislative framework for the provision of discretionary federal programs in Palau, was in force until October 1, 2009. These services continued under program authority in 2010 and 2011.

¹⁷GAO-08-732.

Agreement Would Extend U.S. Assistance for 15 Years, With Annual Decreases

The September 2010 Agreement between the U.S. and Palau governments would extend assistance to Palau to 2024 but steadily reduce the annual amount provided. The Agreement would also extend the authority and framework for U.S. agencies to continue compact federal services and discretionary federal programs.¹⁸

Assistance to Palau Would Decline through 2024

Key provisions of the Agreement would include, among others, extending direct economic assistance to Palau, providing infrastructure project grants and contributions to an infrastructure maintenance fund, establishing a fiscal consolidation fund, and making changes to the trust fund. U.S. assistance to Palau under the Agreement would total approximately \$215 million through 2024.¹⁹

Legislation implementing the Agreement was not approved by Congress during 2011. Department of the Interior provided \$13.1 million for direct economic assistance in 2011 and again in 2012; however, funds were not provided either year for infrastructure projects, the infrastructure maintenance fund, or the fiscal consolidation fund.

- *Direct economic assistance (\$107.5 million).* Under the Agreement, the U.S. government would provide direct economic assistance—budgetary support for Palau government operations and specific needs such as administration of justice and public safety, health, and education—amounting to \$13 million in 2011 and declining to \$2 million by 2023.²⁰ The Agreement also calls for the U.S. and Palau governments to establish a five-member Advisory Group to provide annual recommendations and timelines for economic, financial, and management reforms. The Advisory Group must report on Palau's progress in implementing these or other reforms, prior to annual U.S.-Palau economic consultations.²¹ These consultations are to review Palau's progress in achieving reforms²² such as improvements in fiscal management, reducing the public sector workforce and salaries, reducing government subsidization of utilities, and tax reform. If the U.S. government determines that Palau has not made significant progress in implementing meaningful reforms, direct assistance payments may be delayed until the U.S. government determines that Palau has made sufficient progress.
- *Infrastructure projects (\$40 million).* Under the Agreement, the U.S. government would provide U.S. infrastructure project grants to Palau for mutually agreed infrastructure projects—\$8 million annually through 2013,²³ \$6 million in 2014, and \$5 million in both 2015 and 2016. The Agreement requires Palau to provide a detailed project budget and certified scope of work for any projects receiving these funds.
- *Infrastructure maintenance fund (\$28 million).* Under the Agreement, the U.S. government would make contributions to a fund to be used for maintenance of U.S.-financed major capital improvement projects, including the

¹⁸Other provisions in the Agreement would define reporting and auditing requirements and passport requirements. The Agreement would require that, by 2018, Palau resolve all deficiencies identified in annual single audit reports, which are required by the Compact's fiscal procedures agreement, such that no single audit report recommendations or deficiencies dating from before 2016 remain. In addition, the Agreement alters the entry procedures for citizens of Palau visiting the United States, requiring them to present a valid machine-readable passport to travel to the United States.

¹⁹The compact provided for direct assistance to Palau only through 2009. For 2010 through 2012, Interior provided \$13.1 million for direct assistance to Palau each year. For 2013, Interior's Budget Justification proposed \$34 million in direct assistance, while the Agreement provides for \$25.5 million.

²⁰Congress did not pass legislation appropriating funds for this assistance in 2011 and therefore the earliest this assistance can begin is 2012.

²¹The Agreement requires that Palau undertake economic, legislative, financial, and management reforms giving due consideration to those identified by the IMF; the Asian Development Bank; and other creditable institutions, organizations, or professional firms.

²²The compact requires that the United States and Palau consult annually regarding Palau's economic activities and progress in the previous year, as described in a report that Palau must submit each year. Our 2008 report noted that Palau had met reporting conditions associated with direct assistance but that, contrary to compact requirements, the bilateral economic consultations had not occurred on an annual basis; and had been informal and resulted in no written records. See GAO-08-732.

²³Under the Agreement, the U.S. government would have provided U.S. infrastructure project grants amounting to \$8 million in 2011; however, Congress did not pass legislation appropriating such funds in 2011.

Compact Road and Airai International Airport.²⁴ Through 2024,²⁵ the U.S. government would contribute \$2 million annually, and the Palau government would contribute \$600,000 annually to the fund.²⁶

- *Fiscal consolidation fund (\$10 million).* Under the Agreement, the U.S. government would provide grants of \$5 million each in 2011²⁷ and 2012, respectively, to help the Palau government reduce its debts. Unless agreed to in writing by the U.S. government, these grants cannot be used to pay any entity owned or controlled by a member of the government or his or her family, or any entity from which a member of the government derives income. U.S. creditors must receive priority, and the Government of Palau must report quarterly on the use of the grants until they are expended.
- *Trust fund (\$30.25 million).* Under the Agreement, the U.S. government would contribute \$30.25 million to the fund from 2013 through 2023. The Government of Palau will reduce its previously scheduled withdrawals from the fund by \$89 million.²⁸ From 2024 through 2044, Palau can withdraw up to \$15 million annually, as originally scheduled. Moneys from the trust fund account cannot be spent on state block grants, operations of the office of the President of Palau, the Olibiil Era Kelulau (Palau National Congress), or the Palau Judiciary. Palau must use \$15 million of the combined total of the trust fund disbursements and direct economic assistance exclusively for education, health, and the administration of justice and public safety.

Annual U.S. assistance to Palau under the Agreement would decline from roughly \$28 million in 2011 to \$2 million in 2024. Figure 2 details the timeline and composition of assistance outlined in the Agreement.

²⁴In 2008, we reported that Palau and U.S. officials had expressed concerns about Palau's ability to maintain the Compact Road in a condition that would allow for the desired economic development. We also reported that Palau made initial efforts to maintain the road, but at levels that would cause the road to deteriorate over time and would not provide the economic development benefits envisioned for the people of Palau. See GAO-08-732.

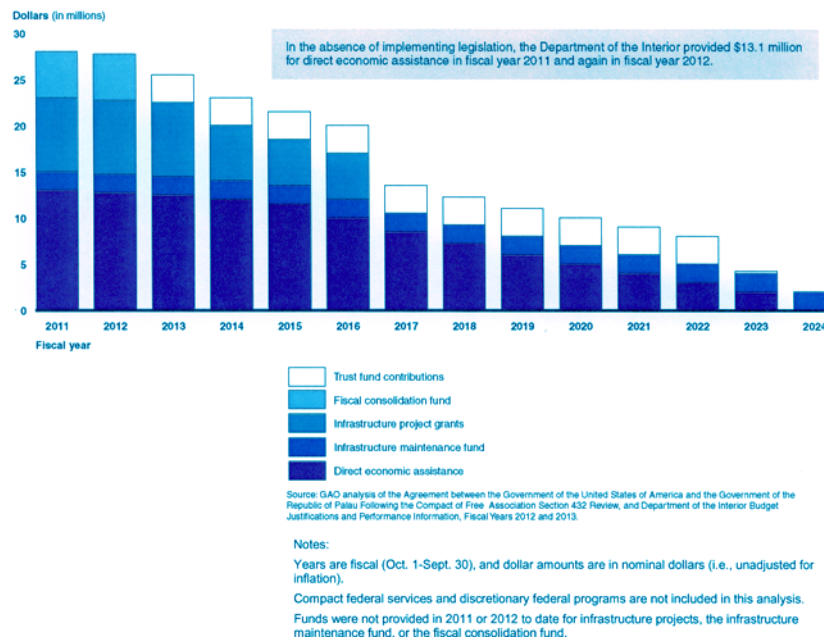
²⁵The Agreement states that the United States shall provide a grant beginning in 2011. However, Congress did not pass legislation appropriating funds for this purpose in 2011 and therefore the earliest the U.S. contributions can begin is 2012.

²⁶Under the compact, Palau owes the United States a total of \$3 million. Under the Agreement, Palau would deposit \$3 million in the infrastructure maintenance fund but not expend it. Any future income derived from the \$3 million must be used exclusively for the maintenance of the Compact Road.

²⁷Although the Agreement states that the United States shall provide a grant beginning in 2011, Congress did not pass legislation appropriating funds for this purpose in 2011 and therefore the earliest the U.S. contributions can begin is 2012.

²⁸Under the Agreement, Palau would withdraw \$5 million annually through 2013 and gradually increase its maximum withdrawal from \$5.25 million in 2014 to \$13 million in 2023.

Figure 2: U.S. Assistance to Palau for 2011-2024, as Outlined in the Agreement



Agreement Would Continue Compact Federal Services and Extend Framework for Discretionary Federal Programs

The Agreement would extend the authority for the provision of compact federal services and discretionary programs in Palau.

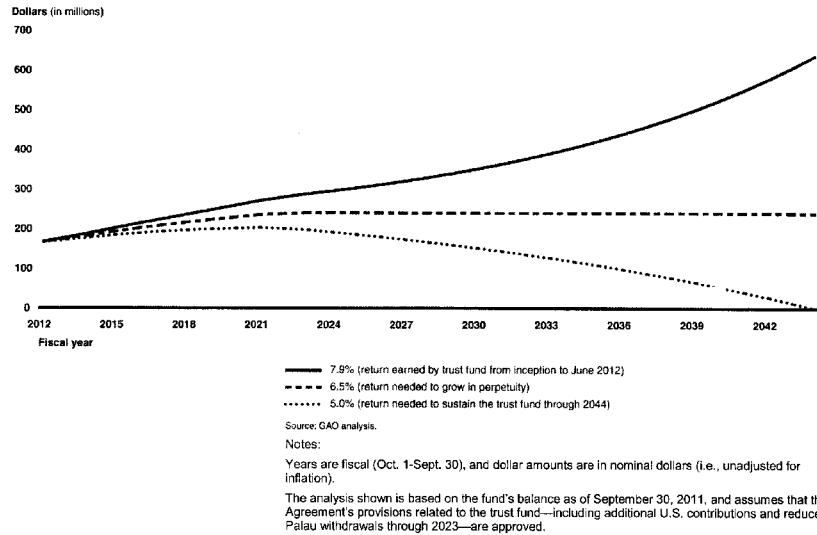
- *Federal services.* The Agreement would amend the compact's subsidiary agreements regarding federal services. Specifically, the Agreement amends the terms of postal, weather, and aviation services to Palau.
- *Federal discretionary programs.* The Agreement would extend the framework for U.S. agencies to provide discretionary federal programs to Palau, with implementation of the programs contingent on annual appropriations to those agencies.

Agreement's Provisions Would Significantly Improve Prospects for Palau Trust Fund

The addition of \$30.25 million in U.S. contributions and the delay of \$89 million in Palau withdrawals through 2023, as provided by the Agreement, would improve the fund's prospects for sustaining scheduled payments through 2044. At the end of June 2012, the fund had a balance of approximately \$163 million. The trust fund would need a 5.0 percent annual return to yield the proposed withdrawals from 2011 through 2044 under the Agreement. This rate is well below the 7.9 percent return that the fund earned from its inception to June 30, 2012.²⁹ Figure 3 shows projected trust fund balances in 2012 through 2044 under the Agreement, with varying rates of return.

²⁹ All rates of return on the trust fund are net of fees and commissions unless otherwise noted.

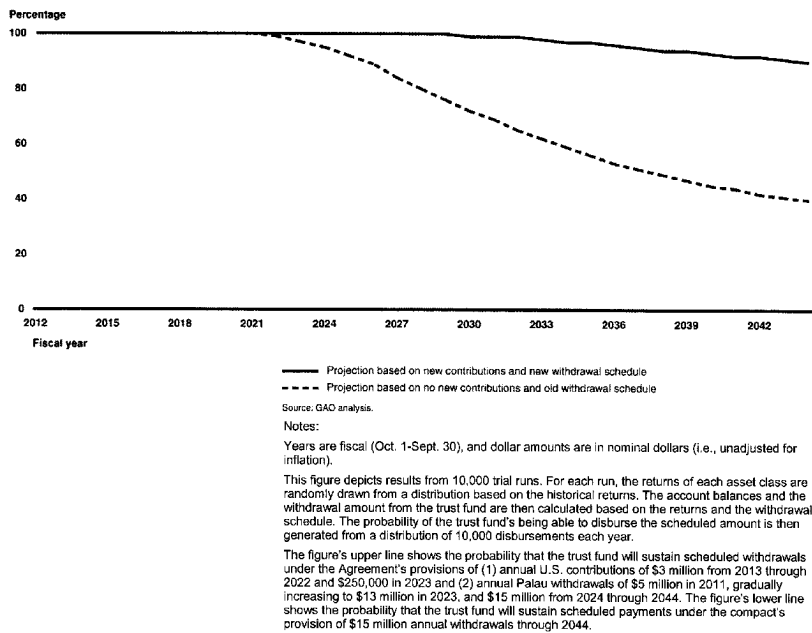
Figure 3: Projected Palau Trust Fund Balance under the Agreement, with Varying Rates of Return, 2012-2044



The additional contributions and reduced withdrawals scheduled in the Agreement would also make the trust fund a more reliable source of revenue under conditions of market volatility. With these changes, the trust fund would have an approximately 90 percent probability of sustaining payments through 2044. In comparison, the fund has a 40 percent probability of sustaining the \$15 million annual withdrawals scheduled under the compact through 2044.

Figure 4 compares the probability that the trust fund will sustain the proposed withdrawals under the terms outlined in the Agreement with the probability that the trust fund will sustain the withdrawals scheduled under the compact.

Figure 4: Probability That Palau Trust Fund Will Sustain Scheduled Withdrawals under Two Scenarios



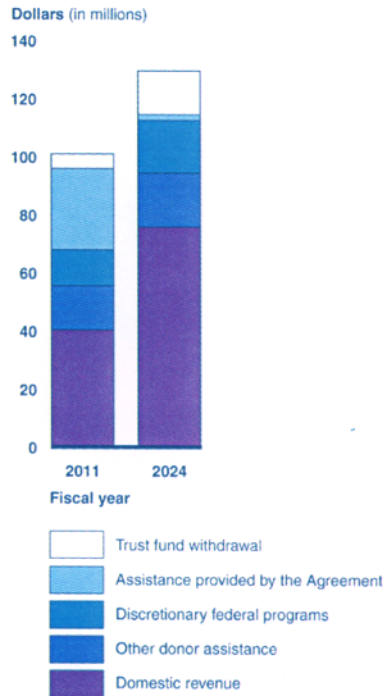
Estimates Prepared for Palau Project Declining Reliance on U.S. Assistance Under the Agreement

Estimates prepared for the Government of Palau project that Palau's reliance on U.S. assistance provided under the Agreement will decline, while its reliance on trust fund withdrawals and domestic revenue will increase.³⁰ These estimates show U.S. assistance, as provided under the Agreement, declining from 28 percent of government revenue in 2011 to less than 2 percent of government revenue in 2024. The estimates also show Palau's trust fund withdrawals growing from 5 percent of government revenue in 2011 to 12 percent in 2024. In addition, the estimates indicate that Palau's domestic revenue will rise from 40 percent of all government revenue in 2011 to 59 percent in 2024.³¹ Finally, the estimates prepared for Palau project a relatively steady reliance on U.S. discretionary federal programs, ranging from 12 percent of all government revenue in 2011 to 14 percent in 2024. The estimates assume that discretionary federal programs will grow at the rate of inflation; however, discretionary programs are subject to annual appropriations and may not increase over time.

Figure 5 shows the types and amounts of Palau's estimated revenues for 2011 and 2024.

³⁰The Government of Palau provided fiscal projections through 2024 to the Senate Committee on Energy and Natural Resources in January 2011. The estimates were prepared by an independent economist retained by the Government of Palau.

³¹In March 2011, the IMF reported that Palau government revenues as a percentage of GDP are below average for island nations in the Pacific. The report cited opportunities for increased tax revenues by eliminating the gross revenue tax, replacing it with a corporate income tax, introducing a Value Added Tax, and increasing the level of taxation on high earners. The IMF also noted that Palau could reform its civil service to decrease wage expenditures. IMF, "Staff Visit to Republic of Palau—Concluding Statement of the IMF Mission" (Mar. 8, 2011).

Figure 5: Estimated Palau Government Revenues for 2011 and 2024

Source: GAO analysis and estimates prepared for the Government of Palau.

Notes:

Years are fiscal (Oct. 1-Sept. 30), and dollar amounts are in nominal dollars (i.e., unadjusted for inflation).

The years shown were chosen to illustrate the trend in Palau's revenues from 2011, when the terms proposed by the Agreement would begin, through 2024, when assistance provided by the Agreement would expire.

Federal services were not included in the estimates prepared for Palau.

"Trust fund withdrawal" includes the maximum withdrawal for 2011 and 2024 as specified in the Agreement.

"Assistance provided by the Agreement" includes all funding specified in the Agreement.

"Discretionary federal programs" includes estimates prepared for the government of Palau for program funding and grants from U.S. agencies in 2011 and 2024.

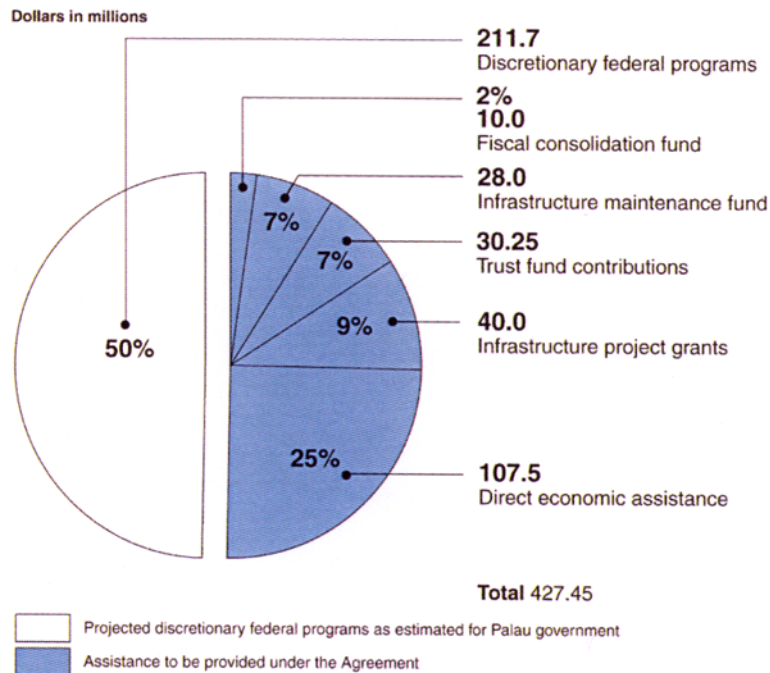
"Other donor assistance" includes estimates for assistance from other foreign donors for 2011 and 2024.

"Domestic revenue" includes estimates of taxes and fees to be collected by the Palau government in 2011 and 2024.

Estimates Prepared for Palau Project Discretionary Program Funding as Half of U.S. Assistance

The estimates prepared for the Government of Palau project that U.S. assistance to Palau from 2011 through 2024, including discretionary federal programs, will total approximately \$427 million. The estimates further project that discretionary programs will account for nearly half of U.S. assistance through 2024, with assistance amounts specified in the Agreement accounting for the other half. (See fig. 6.) In contrast, in 2008, we estimated discretionary program funding accounted for less than one-third of total U.S. assistance to Palau from 1995 through 2009.

Figure 6: U.S. Assistance to Palau in 2011-2024 as Estimated for Palau and as Provided under the Agreement



Source: GAO analysis of the Agreement between the Government of the United States of America and the Government of the Republic of Palau Following the Compact of Free Association Section 432 Review, estimates prepared for the Government of Palau.

Notes:

Years are fiscal (Oct. 1-Sept. 30), and dollar amounts are in nominal dollars (i.e., unadjusted for inflation).

The analysis depicted is based on the estimates prepared for the government of Palau and on the Agreement's provisions. This analysis does not include federal services, which are not addressed in the estimate prepared for Palau and generally are not specified in the Agreement.

"Discretionary federal programs" includes all funds appropriated to federal agencies for assistance to Palau. The discretionary federal program estimates prepared for the government of Palau include annual adjustments for inflation, but not for population growth, from 2009 through 2024. Although the Agreement does not specify funding for discretionary federal programs, it extends authority for U.S. agencies to provide them in Palau subject to annual appropriations.

Pending Legislation Would Approve and Implement the Agreement

Legislation has been introduced in both the Senate and the House that would approve and implement the September 2010 agreement between the U.S. and Palau governments.

In February 2011, a bill was introduced in the Senate that would implement the Agreement, as written.³² The Senate bill would authorize and appropriate funds to Interior for specified assistance. The Senate bill would also extend the authority, and authorize appropriations, for the provision of compact federal services in Palau. However, the proposed legislation does not appropriate funds for compact federal services. As of September 2012, the Senate has not acted on this bill.

³² S. 343.

In June 2012, a bill was introduced in the House that would approve and implement the Agreement, with some modifications.³³ Specifically, the pending House bill:

- Shifts the timing of the provision of some specified Agreement assistance to account for the fact that fiscal year 2011 has passed.
- Extends the full faith and credit provision of the compact³⁴ to the U.S. commitments of assistance under the Agreement for direct economic assistance, the trust fund, the infrastructure maintenance fund, the fiscal consolidation fund, and infrastructure projects.
- Applies an inflation adjustment to the Agreement assistance for direct economic assistance and infrastructure project grants, and payments to the trust fund, infrastructure maintenance fund, and fiscal consolidation fund.³⁵
- Extends a pledge of the full faith and credit of the United States for the full payment of the amounts necessary to conduct the audits of the assistance provided, as called for under the Agreement.³⁶

In addition, the Senate and House bills implementing the Agreement would amend the sections of the Agreement that extend the authority for the provision of compact federal services and discretionary programs in Palau. The proposed Senate and House legislation would authorize annual appropriations for weather and aviation services.³⁷ The proposed Senate and House legislation would extend the eligibility of the people, government, and institutions of Palau for certain discretionary programs, including special education and Pell grants.³⁸ However, the proposed bills differ in how they would authorize appropriations to subsidize postal service to Palau, the Republic of the Marshall Islands, and the Federated States of Micronesia. The Senate legislation would have authorized appropriations of \$1.5 million to Interior for 2011 through 2024, to subsidize postal services provided by the U.S. Postal Service.³⁹ The proposed House legislation would authorize appropriations of \$1.5 million to Interior beginning in 2012 and through 2024, to subsidize postal services. Under the proposed House bill, Interior would be authorized to transfer these funds to the U.S. Postal Service under the condition that domestic postage may be used for mail to these countries.⁴⁰

Chairman Fleming, Ranking Member Sablan, and Members of the Subcommittee, this completes my prepared statement. I would be happy to respond to any questions you may have at this time.

GAO Contact and Staff Acknowledgments

For further information about this statement, please contact David Gootnick at (202) 512-3149 or gootnickd@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement.

Emil Friberg (Assistant Director), Ming Chen, David Dayton, Brian Hackney, Reid Lowe, Grace Lui, and Valérie L. Nowak made key contributions to this statement. Robert Alarapon, Benjamin Bolitzer, Rhonda Horried, Farahnaaz Khakoo, Jeremy Sebest, Cynthia Taylor, and Anu Mittal provided technical assistance.

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³³ H.R. 6040.

³⁴ Pursuant to this compact provision, should the United States fail to provide a payment covered by the pledge, Palau would be able to seek relief in the U.S. Claims Court or its successor court.

³⁵ Adjusting direct economic assistance, infrastructure project grants, and payments to the trust fund, infrastructure maintenance fund, and fiscal consolidation fund for inflation would increase the value of U.S. assistance to Palau. Our analysis shows that adjusting for inflation and reducing fiscal consolidation fund as outlined in H.R. 6040, the value of U.S. contributions would increase approximately \$12 million.

³⁶ Under the Agreement, the Government of Palau is to bear the cost of these audits. According to an Interior official, the cost of the audits is approximately \$500,000 per year.

³⁷ S. 343 as introduced in the Senate and H.R. 6040 as introduced in the House.

³⁸ *Ibid.*

³⁹ S. 343.

⁴⁰ H.R. 6040.

Appendix I: U.S. Assistance to Palau Provided Under the Compact and Outlined in the Agreement

Table 2 shows the assistance provided to Palau under the compact from 1995 through 2009. Table 3 shows the proposed assistance to Palau for 2011 through 2024, as outlined in the Agreement.

Table 2: Compact Assistance Provided to Palau in 1995-2009

Dollars in millions																
Types of assistance	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	Total
Direct assistance	\$126.5	\$23.5	\$22.4	\$21.2	\$13.6	\$13.6	\$13.8	\$13.9	\$14.1	\$14.1	\$12.7	\$12.8	\$12.9	\$13.0	\$13.1	\$341.1
Infrastructure	53.0	0	96.0	0	0	0	0	0	0	0	0	0	0	0	0	149.0
Trust fund contributions	66.0	0	4.0	0	0	0	0	0	0	0	0	0	0	0	0	70.0
Total	\$245.5	\$23.5	\$122.4	\$21.2	\$13.6	\$13.6	\$13.8	\$13.9	\$14.1	\$14.1	\$12.7	\$12.8	\$12.9	\$13.0	\$13.1	\$560.1

Source: GAO analysis of the Interior OIA Budget Justifications and Performance Information fiscal year 2012.

Note: Years are fiscal (Oct. 1-Sept. 30), and dollar amounts are in nominal dollars (i.e., unadjusted for inflation).

Table 3: Proposed Assistance to Palau as Outlined in the Agreement

Dollars in millions																
Types of assistance	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Total	
Trust fund contributions	\$0	\$0	\$3.00	\$3.00	\$3.00	\$3.00	\$3.00	\$3.00	\$3.00	\$3.00	\$3.00	\$3.00	\$0.25	\$0	\$30.25	
Infrastructure maintenance fund	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	28.00	
Infrastructure project grants	8.00	8.00	8.00	6.00	5.00	5.00	0	0	0	0	0	0	0	0	40.00	
Fiscal consolidation fund	5.00	5.00	0	0	0	0	0	0	0	0	0	0	0	0	10.00	
Direct economic assistance	13.00	12.75	12.50	12.00	11.50	10.00	8.50	7.25	6.00	5.00	4.00	3.00	2.00	0	107.50	
Total	\$28.00	\$27.75	\$25.50	\$23.00	\$21.50	\$20.00	\$13.50	\$12.25	\$11.00	\$10.00	\$9.00	\$8.00	\$4.25	\$2.00	\$215.75	

Source: GAO analysis of the Agreement between the U.S. government and the government of the Republic of Palau following the Compact of Free Association Section 432 review.

Note: Years are fiscal (Oct. 1-Sept. 30), and dollar amounts are in nominal dollars (i.e., unadjusted for inflation).

Appendix II: U.S. Discretionary Program Funds Expended in 2009

Table 4 lists discretionary U.S. federal program funds expended by the Palau national government, the Palau Community College, and the Palau Community Action Agency, as reported in the organizations' single audit reports for 2009.

Table 4: U.S. Federal Program Expenditure in Palau as Reported in 2009 Single Audit Reports

U.S. agency	Federal program	2009 expenditure
Agriculture	Cooperative Forestry Assistance	\$155,422
Agriculture	Community Facilities Loans and Grants	124,745
Agriculture	Unknown	1,604
Commerce	Special Oceanic and Atmospheric Projects	306,485
Commerce	Unallied Management Projects	1
Education	Pell Grant	2,250,348
Education	Freely Associated States-Education Grant Program	1,324
Education	Special Education-Grants to States	859,119
Education	Upward Bound Program	315,164
Education	Talent Search	204,406
Education	Upward Bound Math and Science	198,998
Education	Gaining Early Awareness and Readiness for Undergraduate Programs	198,205
Education	Student Support Services Program	189,771
Education	Special Education-Grants to States	122,755
Education	Federal Work-Study	109,923
Education	Academic Competitiveness Grant	78,346
Education	Supplemental Educational Opportunity Grant	52,600
Education	Byrd Honors Scholarships	46,500
Education	Adult Education-State Grant Program	29,038
HHS	Head Start	1,670,508
HHS	CDC and Prevention-Investigations & Technical Assistance	976,068
HHS	Consolidated Health Centers	564,525
HHS	Substance Abuse and Mental Health Services-Projects of Regional and National Significance	431,171
HHS	National Bioterrorism Hospital Preparedness Program	387,003
HHS	Public Health Emergency Preparedness	343,717
HHS	Epidemiologic Research Studies of AIDS and HIV Infection in Selected Population Groups	260,367
HHS	Maternal and Child Health Federal Consolidated Programs	201,257
HHS	Family Planning-Services	171,235
HHS	Maternal and Child Health Services Block Grant to the States	149,718

U.S. agency	Federal program	2009 expenditure
HHS	Project Grants and Cooperative Agreements for Tuberculosis Control Programs	116,313
HHS	Immunization Grants	113,372
HHS	Block Grants for Prevention and Treatment of Substance Abuse	111,340
HHS	Universal Newborn Hearing Screening	95,591
HHS	DEH-PHCl	72,266
HHS	Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	67,785
HHS	Basic/Core Area Health and Education Center	62,506
HHS	Block Grants for Community Mental Health Services	58,245
HHS	Consolidated Knowledge Development and Application (KD&A) Program	55,430
HHS	Preventive Health Services - STD Control Grants	48,079
HHS	Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation and Surveillance Systems	44,845
HHS	HIV Care Grants	38,249
HHS	ARRA-Grants to Health Center Programs	20,990
HHS	HIV/Aids Surveillance	19,372
HHS	Preventive Health and Health Services Block Grant	17,375
HHS	Drug Free Communities Support Program Grants	12,759
HHS	Civil Rights and Privacy Rule Compliance Activities	12,620
Interior	Social, Economic and Political Development of the Territories	628,346
Interior	Historical Preservation-Grants in Aid	254,436
Justice	Juvenile Justice and Delinquency Prevention-Allocation to States	1
Labor	ARRA WIA Dislocated Workers Program	128,027
Labor	WIA Dislocated Workers Program	118,574
Labor	ARRA WIA Youth Activities	81,112
Labor	WIA Adult Program	63,241
Labor	WIA Youth Activities	62,637
Labor	ARRA WIA Adult Program	49,162
Transportation	Airport Improvement Program	\$4,309,980
Total		\$18,370,956

Source: GAO analysis of Republic of Palau National Government Independent Auditor's Reports on Internal Control and on Compliance. Year Ended September 30, 2009; Palau Community College Comprehensive Annual Financial Report Fiscal Year Ended September 30, 2009; and Palau Community Action Agency Report on the Audit of Financial Statements in Accordance with CMB Circular A-133 Year Ended September 30, 2009.

Notes:

Year is fiscal (Oct. 1-Sept. 30), and dollar amounts are in nominal dollars (i.e., unadjusted for inflation).

HHS = Department of Health and Human Services.

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HIGHLIGHTS

September 10, 2012

COMPACT OF FREE ASSOCIATION Proposed U.S. Assistance to Palau through Fiscal Year 2024

Why GAO Did This Study

The Compact of Free Association between the United States and the Republic of Palau, which entered into force in 1994, provided for several types of assistance aimed at promoting Palau's self-sufficiency and economic advancement. Included were 15 years of direct assistance to the Palau government; contributions to a trust fund meant to provide Palau \$15 million each year in fiscal years 2010 through 2044; construction of a road system, known as the Compact Road; and federal services such as postal, weather, and aviation. U.S. agencies also provided discretionary federal programs related to health, education, and infrastructure. In 2008, GAO pro-

jected that total assistance in fiscal years 1994 through 2009 would exceed \$852 million.

In September 2010, the United States and Palau signed an agreement (the Agreement) that would, among other things, provide for additional assistance to Palau beginning in fiscal year 2011 and modify its trust fund. Currently, there are two bills pending before Congress to implement the Agreement.

In this testimony, GAO updates a November 2011 testimony on (1) the Agreement's provisions for economic assistance to Palau, (2) its impact on the trust fund's likelihood of sustaining scheduled payments through fiscal year 2044, (3) the projected role of U.S. assistance in Palau government revenues, and (4) the pending legislation to implement the Agreement. GAO reviewed current trust fund data and new pending legislation for this testimony.

What GAO Found

The Agreement would provide decreasing assistance, totaling approximately \$215 million through fiscal year 2024 and includes the following:

- direct economic assistance (\$107.5 million) for Palau government operations;
- infrastructure project grants (\$40 million) to build mutually agreed projects;
- infrastructure maintenance fund (\$28 million) for maintaining the Compact Road, Palau's primary airport, and certain other major U.S.-funded projects;
- fiscal consolidation fund (\$10 million) to assist Palau in debt reduction; and
- trust fund contributions (\$30.25 million) in addition to the \$70 million contributed under the compact

Assistance to Palau Specified in the Agreement

Notes: All dollar amounts are in nominal dollars (i.e., unadjusted for inflation). Funds were not provided in fiscal years 2011 or 2012 to date for infrastructure projects, the infrastructure maintenance fund, or the fiscal consolidation fund.

Under the Agreement, the United States would contribute to the trust fund in fiscal years 2013 through 2023, and Palau would reduce its withdrawals by \$89 million in fiscal years 2010 through 2023. GAO projects that the fund would have a 90 percent likelihood of sustaining payments through fiscal year 2044 with these changes, versus 40 percent without these changes.

Estimates prepared for the Palau government project declining reliance on U.S. assistance under the Agreement—from 28 percent of government revenue in fiscal year 2011 to 2 percent in fiscal year 2024—and growing reliance on trust fund withdrawals and domestic revenues. The estimates show trust fund withdrawals rising from 5 percent to 24 percent and domestic revenues rising from 40 to 59 percent, of total government revenue. According to the estimates, U.S. assistance in fiscal years 2011 through 2024 would total \$427 million, with discretionary federal programs accounting for about half of that amount.

Congress has not approved legislation to implement the Agreement as of September 2012. Pending Senate legislation would implement the Agreement and appropriate funds to do so. Pending House legislation would implement the agreement, apply an inflation adjustment to assistance payments, and shift the timing of certain assistance payments to reflect the fact that 2011 has passed.

Dr. FLEMING. All kidding aside, we do appreciate the time and effort that you put into your testimonies, and I realize sometimes it is difficult to get it all in timely. At this point, we will begin Member questioning of witnesses. To allow all Members to participate and ensure we hear from all of our witnesses today, Members are limited to 5 minutes for their questions. However, if Members have additional questions, we can have more than one round of questioning and we usually do. I now recognize myself for 5 minutes.

Free association did not exist before it was used for the Republic of Palau and the other two compacts with the Republic of the Marshall Islands and Federated States of Micronesia. Can either Secretary here today discuss why this type of association was agreed to by the United States? And a second part of that question, was it the intent of the Compact for the United States to provide funding to Palau for the life of the Compact outside of the trust fund?

Mr. BABAUTA. I will attempt to answer the question, Mr. Chairman. As I understand the history of the trust territories and eventually maturing to a point they were granted free association which is the relationship between us and them. It was the United States responsibility at the time——

Dr. FLEMING. Make sure your mic is close to you.

Mr. BABAUTA. It was my understanding the United States took on the responsibility shortly after World War II and it received those areas that were designated as trust territories of the Pacific Islands under the United Nations with an agreement that under the United States, our country would attempt to assist them to a point where they are mature politically and can seek a different status, a different relationship. As you know we have the three freely associated states and the Commonwealth of the Northern Mariana Islands and they elected to go a different route in its maturation process.

Dr. FLEMING. OK. It was the intent of the Compact, I am not sure if I heard——

Mr. BABAUTA. About funding outside?

Dr. FLEMING. About the funding outside of the trust fund?

Mr. BABAUTA. I would not know the answer to that question, sir.

Dr. FLEMING. Secretary Kagan?

Mr. KAGAN. Unfortunately Mr. Chairman I don't know the answer either in terms of what the original intent was, but we would certainly be happy to go and look for that to get you a good answer.

Dr. FLEMING. Yes, I would appreciate you getting back to us. Again, for historical perspective, really all three compacts, Marshall Islands, Micronesia and Palau were very important areas during World War II. Micronesia, Palau were great staging areas for bombing, and they prove even today to be very important strategic areas. And so this is certainly something that we need to focus on.

Secretary Babauta, you mentioned in your testimony that Palau has made strong economic gains under the Compact that its growth in real terms has averaged over 2 percent per year, which really looks pretty good compared to what we are seeing today on Conis. And Palau's governmental services are a meeting the needs of the community. What funding or revenue support these Palau government services, local revenues our outside funding?

Mr. BABAUTA. Well, under the new agreement, sir?

Dr. FLEMING. Well, I guess really what I am asking about is the economy itself, it has 2 percent GDP growth right? So what is sustaining that? Is this outside flow of money? Is this growth in the economy internally? What is driving that GDP?

Mr. BABAUTA. What is driving Palau's economy is tourism. Back in 2005, when we turned over the Compact road to them, at the time, Palau was receiving tourists at 76,000 per year. I just recently went to Palau in the beginning of August and talked to their leadership and President Toribiong. And they report now their tourism is up at 110,000 tourists per year. And they have managed to contain their government growth so that they are able to provide money for education in the community college and make the right investments to take care of their people.

Dr. FLEMING. And where are the bulk of visitors coming from?

Mr. BABAUTA. They actually come from all over, sir. I think the most recent spike in their tourism has been from China, but generally, it is one of the top five dive spots in the world so they are frequented from visitors all over the globe.

Dr. FLEMING. I recall back in the day, Japanese visitors were the main source. I guess it has changed over to Chinese visitors. Is it still a very sought after scuba diving haven?

Mr. BABAUTA. I have not scuba dived there yet, but yes, apparently with their visitors who frequent there yes, it still is.

Dr. FLEMING. Well, it is legendary in its scuba diving and I myself never got make it there, even though I was fairly close. Well, these are important things, we will revisit some of them in a moment when we get back to our second round. Every time we start these trust funds and we have this flow of money to various islands, island states around the world, it is obviously important that we create a sustainable economy, and that is certainly something that we will need to focus on more in these discussions. I now yield to gentleman, Mr. Sablan, for 5 minutes.

Mr. SABLAN. Thank you very much, Mr. Chairman. And let me just say something, while it may not be written in the law on the intention to continue reviewing and continue to provide assistance to the Republic of Palau, I think there is this spirit of the arrangement, the Compact arrangements that the United States would look at ways to assist the Republic of Palau and their needs in the 15-, 30-, and 40-year period.

Mr. Chairman, coming from an islander, I learned how to scuba dive just to dive in Palau, so we should all go out there together, sir, and I will watch you dive.

Welcome, Secretary Babauta, Secretary Kagan and Dr. Gootnick. Let me start with you, Secretary Kagan. The Compact provides that the United States will conduct audits at once of its compact assistance. It says the agreement now shifts the costs to Palau. I understand that this provision doesn't exist with the Republic, for the Marshalls and the Federated States of Micronesia, so the cost can be less than \$500,000 for an audit.

So wouldn't it be in our best interest for the United States, would we have a greater assurance of getting the audits at once if the United States continued to provide for these audits? And why should Palau have greater responsibility for audits of the used funds that the U.S. wants than the other two freely associated states?

Mr. KAGAN. Mr. Sablan, thank you very much for the question, it is an excellent question, and reflects your focus and understanding of these issues. I think the first thing I would say is that while obviously the three Compact states share a number of similarities, from our standpoint we do believe that it is very important to treat them separately for a number of reasons having do with different circumstances in each country as well as obviously the different histories of our engagement there.

In terms of specific provisions, I should note we strongly support the regular audits, and these audits we think have been very effective at promoting our shared interest ensuring efficient use of Compact funds. As to the question of cost, this was something that was negotiated between us. There were obviously discussions on this,

and I think that the, very fundamentally, I think the feeling was that this reflected some of the circumstances that evolved in the last 15 years.

You know, we believe that Palau has a very strong commitment to ensuring transparency and integrity in the use of Compact funds and don't believe that this is a particular challenge in terms of the possibility that shifting the burden of cost might lead to a change in the audit.

Mr. SABLON. I am going to run out of time, Secretary, and that is why you are the diplomat here. Let me say something, you are speaking to a Micronesian, and \$500,000 is a lot of money anywhere, but \$500,000 for a small country like Palau is a huge amount of money that they could use better. So I am asking, why are you treating them differently than you do the Republic of Marshall or FSM? That is a concern I have and could we eventually get an answer?

My second issue here, Secretary Kagan, is that the Department of State is concerned about specific provisions in the bill and that the bill would extend benefits and funding to Palau that would run counter to the carefully calibrated goals of the Administration and the negotiations. The provisions to which you refer are continuations of provisions of the Compact, similar to provisions included in the revised compacts with the other two freely associated nations negotiated by the Executive Branch, approved by Republican Congress in 2003. And in one case, through a Congressional addition to the negotiated revised compacts, there are millions more in costs that would not add to the cost of the bill and would be offsetting costs by the intended amount of offsets to the bill.

My understanding, sir, is that the negotiators for the Republic of Palau were just ready to throw their arms up because of the negotiating tactics and things like that. But what consideration does the Administration's carefully calibrated goals give to those factors, outside related to the provisions to which you referred, would you recommend to veto the bill with this provision? And do you think the Department would? The additions to the bill separate from the negotiated bill, the agreement?

Mr. KAGAN. I think that our view is first that this was negotiated over some period of time, and I think it is usual in negotiations for both sides at times to be frustrated with the other. I think we are happy that we have reached agreement and there was strong support both by the Government of Palau and by the Administration. Our view is that in doing this, as in any negotiation, there were trade-offs that were made on a variety of issues, and we believed the resulting agreement was one that reflected those trade-offs accurately. As I said before, we do have concerns about this. As to your final question, I would note we stand ready to work with the Committee and with Members to address those. Obviously we very strongly support—

Mr. SABLON. Thank you. Because in exchange for this agreement we have—our relationship with Palau is significant in terms of the United States national security interest in the Pacific. It starts at Hawaii and goes all the way up to the Northern Marianas and up to Okinawa in Japan and the Philippines. I will yield back the bal-

ance of my time to the second round of questions. Thank you. Thank you, Secretary.

Dr. FLEMING. The gentleman yields back. Mr. Faleomavaega you have 5 minutes, sir.

Mr. FALEOMAVAEGA. Thank you, Mr. Chairman, and our Ranking Member for your leadership and initiative in calling this important hearing concerning the proposed legislation we are now considering. I want to focus specifically on H.R. 6040, which is concerning the Palau situation.

Mr. Chairman, I would like unanimous consent to have the full text of my statement be made part of the record.

Dr. FLEMING. I am sorry, sir I didn't hear.

Mr. FALEOMAVAEGA. I would like to request that the full text of my statement be made a part of the record.

Dr. FLEMING. Without objection, so ordered.

[The prepared statement of Mr. Faleomavaega follows:]

Statement of The Honorable Eni F.H. Faleomavaega, a Delegate in Congress from American Samoa

Mr. Chairman:

Thank you and our Ranking Member, Mr. Sablan, for your leadership in holding today's hearing on this important legislation to continue free association with Palau through Fiscal Year 2024. Enactment of this legislation without further delay is imperative for security, diplomatic, and economic reasons.

As Ranking Member of the Foreign Affairs' Subcommittee on Asia and the Pacific, I co-authored H.R. 6040 with Chairman Manzullo. For the record, fourteen other Members have joined us as original co-sponsors. Seven Members of the Subcommittee on Fisheries, Wildlife, Oceans and Insular Affairs have formally supported the bill.

H.R. 6040 would approve and slightly modify terms for continuing free association with Palau developed pursuant to the Compact of Free Association negotiated by the Reagan Administration and approved by law under the George H.W. Bush Administration. The Department of Defense has written to the Congress that "[f]ailure to follow through on our commitments to Palau, as reflected in the proposed legislation, would jeopardize our defense posture in the Western Pacific".

According to the DoD, Palau is "irreplaceable" because the islands cover a strategic expanse of the Pacific as big as Texas. The Compact right of the United States to deny access to other nations prevents countries like China from using sea-lanes that needs for economic and military expansion. The Pentagon has made this very clear with a translation of a Chinese sea strategy map, which I include with this statement. It shows Palau as a key link in an island chain running from Japan down to Indonesia that China wants to break through. It has no chance, other than if the Congress fails to approve this bill. If we fail to do so, China will fill the gap and shatter the chain of defense by offering their own kind of assistance to Palau.

The Department of State has similarly written that continuing free association with Palau is "vital" for the United States. It is important to know that Palau votes with the U.S. in the United Nations more than any other member. This is critical on issues such as those concerning Israel and Cuba on which we would otherwise be isolated. The Arab League and Cuba have offered Palau aid in return for changing its votes. But as you know, the current administration in Palau has declined, standing firmly with the United States.

Under the Compact, the decision of whether to continue free association and Palau's U.S. assistance needs through FY 2024 were to be determined in a bilateral review and was implemented in FY 2010. However, the review was not completed until two years ago. It settled upon a phase out of direct assistance, which would total much less than during the first period of free association, in contrast to the substantial increases agreed to by the George W. Bush Administration and the Republican Congress in 2003 in the revised compacts with the two other freely associated states.

Leaders on both sides of the aisle on both sides of the Capitol have expressed strong support for legislation to provide at least what was agreed to in the review and no Member of Congress has questioned it.

The Administration's draft bill did not include measures to offset the cost. After being pressed for such measures, it suggested proposals that Ranking Member Markey as well as Chairman Hastings said could still not pass the Committee on Natural Resources, their counterparts in the Senate committee agreed that they were not viable, and chairmen of both appropriations committees also agreed that the offsets were not acceptable.

Chairman Manzullo introduced new legislation with other offsets. One is in the Foreign Affairs bill before you and is agreed to by the Senate. It is intended to more than cover the costs of the bill and would make this a net savings measure. The Speaker and the Majority Leader are now discussing the options with Foreign Affairs Chairwoman Ros-Lehtinen and Manzullo to enable the bill to pass the House as soon as possible.

They understand that the long delay has led some Palauans to question the Compact Review Agreement and the commitment of the United States to the association and the serious potential losses for our country, especially under the full faith and credit clause of the U.S. constitution.

The Compact was not approved in Palau until the Congress under President George H. W. Bush added some provisions to the negotiated Compact to address Palauan concerns. In fact, all free association agreement laws to date have had such provisions.

H.R. 6040 includes only a few but they are very much needed. They address concerns increasingly raised by Palauans and are prudent since Palau, too, needs to approve the Agreement. Members of Congress said these provisions should be included in the Agreement when it was being negotiated. The provisions would be consistent with the Agreement to the Compact and also include the revised compacts approved by the Republican Congress in 2003. The bill's cost offset is intended to more than make up for the cost.

Mr. Chairman, these provisions are modest, well justified, and precedented. They perfect a very good Agreement. I respectfully urge you to act so that the bill can be enacted into law very soon as it needs to be in the interests of our great nation.

Mr. FALEOMAVAEGA. Thank you. I have listened with tremendous interest in terms of the statements made by our friends from the Interior Department, and also from the State Department, quite complimentary, and all have stated a sense that Palau and this region of the world is vitally important to the interest of the United States.

Mr. Chairman, I submit I just wish the rhetoric would match the substance in terms of how we really have been treating these island countries of this region.

With all due respect, Secretary Kagan, since you are new on the job, I have been very, very disappointed, both Democratic and Republican Administrations have never really taken the Pacific Island countries of this region of the world seriously. The only real foreign policy we have toward this region, Mr. Chairman, is really toward New Zealand and Australia. These island countries are only incidental to our foreign policy, which we have no foreign policy for the Pacific Island countries. It is primarily toward New Zealand and Australia.

The question that the Chairman raised earlier, the reason why we have authority over these islands was specifically after World War II, unilaterally we just declared this region as a strategic trust. With or without the United Nations' approval, we just took over. It was vital and it was part of our strategic and military interest, that is the reason why we are there, that is the reason why we ended up with three Compact associations because the Russians and the Cubans and the Communists in the United Nations were constantly criticizing the United States for having a colonial rule over the island countries. So rather than continue the trust territory, the Pacific Islands, we negotiated these Compacts of Free As-

sociation and we have three entities: Republic of the Marshall Islands, Federated States of Micronesia, and the Republic of Palau.

So now, what is it that we have? Primarily our number one priority is to make sure that our strategic and military interests are protected. It is not because of these islands have oil and gas or resources and such that we have any real economic interest, it is primarily strategic and military. And I will say that I am utterly disappointed, the fact that for 2 years we have been dragging this issue, finally having to come to the Congress to do something by trying to find some sort of offsets to meet the requirements that we have under the terms of the Compact.

My understanding Mr. Chairman, the U.S. Constitution pledges its full faith in credit clauses in whatever the government of the United States has obligations, and one is toward Palau as part of the Compact agreements that we had with this country, guaranteeing our presence in times of war and emergency for 50 years that we could use Palau. And I might also add, Mr. Chairman, that this issue is very critical when we are looking at the South China Sea, and the issues we are now confronted with China and all the problems with the Asian countries, I think the question that we have now that we have to answer, is Palau relevant to our overall strategic and military interest right now in the Pacific? And I say, Mr. Chairman, it better be, because right now a lot of Palauan leaders are seriously questioning the integrity of our own government whether or not we are willing to fulfill our obligations and commitments financially in terms of what we agreed upon in terms of the Compact.

I realize my time is up, Mr. Chairman. I haven't had a chance to even ask one question, but I really, really thank you for your leadership and wanted to see this through. But I have about 100 questions that I want to wait for the second round. I just want to give that as an opener, and my real concern, Mr. Chairman, is that we are not paying enough attention. So we don't even have USAID presence, if we did it was only a million dollars for the budget, Mr. Kagan, while China has a \$600 million economic development program for these island nations. Do you think they are stupid not to realize that we really don't care, we really don't have interest except for New Zealand and Australia, that is basically our foreign policy toward the Pacific. I am sorry, Mr. Chairman, I will wait for the second round.

Dr. FLEMING. I thank the gentleman. I believe the gentleman has framed the issue very well. The Chairman now recognizes Ms. Bordallo the gentlelady from Guam.

Ms. BORDALLO. Thank you, Mr. Chairman. I ask unanimous consent that an August 1st article from The Washington Post entitled, "U.S. Model For a Future War Fans Tensions With China and Inside Pentagon," as well as an accompanied map illustrating the U.S. force posture in the Asia-Pacific region be included in the record. I believe this article and map highlight the importance of why we need to pass the Compact renewal with Palau.

Dr. FLEMING. We have a copy of that.

Ms. BORDALLO. I hope this doesn't cost me time.

Dr. FLEMING. We will reset the time for the gentlelady. Without objection so ordered so approved.

[The article and maps follow:]

The Washington Post Company

U.S. model for a future war fans tensions with China and inside Pentagon

By Greg Jaffe, Published: August 1, 2012

When President Obama called on the U.S. military to shift its focus to Asia earlier this year, Andrew Marshall, a 91-year-old futurist, had a vision of what to do.

Marshall's small office in the Pentagon has spent the past two decades planning for a war against an angry, aggressive and heavily armed China.

No one had any idea how the war would start. But the American response, laid out in a concept that one of Marshall's longtime proteges dubbed "Air-Sea Battle," was clear.

Stealthy American bombers and submarines would knock out China's long-range surveillance radar and precision missile systems located deep inside the country. The initial "blinding campaign" would be followed by a larger air and naval assault.

The concept, the details of which are classified, has angered the Chinese military and has been pilloried by some Army and Marine Corps officers as excessively expensive. Some Asia analysts worry that conventional strikes aimed at China could spark a nuclear war.

Air-Sea Battle drew little attention when U.S. troops were fighting and dying in large numbers in Iraq and Afghanistan. Now the military's decade of battling insurgencies is ending, defense budgets are being cut, and top military officials, ordered to pivot toward Asia, are looking to Marshall's office for ideas.

In recent months, the Air Force and Navy have come up with more than 200 initiatives they say they need to realize Air-Sea Battle. The list emerged, in part, from war games conducted by Marshall's office and includes new weaponry and proposals to deepen cooperation between the Navy and the Air Force.

A former nuclear strategist, Marshall has spent the past 40 years running the Pentagon's Office of Net Assessment, searching for potential threats to American dominance. In the process, he has built a network of allies in Congress, in the defense industry, at think tanks and at the Pentagon that amounts to a permanent Washington bureaucracy.

While Marshall's backers praise his office as a place where officials take the long view, ignoring passing Pentagon fads, critics see a dangerous tendency toward alarmism that is exaggerating the China threat to drive up defense spending.

"The old joke about the Office of Net Assessment is that it should be called the Office of Threat Inflation," said Barry Posen, director of the MIT Security Studies Program. "They go well beyond exploring the worst cases. . . . They convince others to act as if the worst cases are inevitable."

Marshall dismisses criticism that his office focuses too much on China as a future enemy, saying it is the Pentagon's job to ponder worst-case scenarios.

"We tend to look at not very happy futures," he said in a recent interview.

China tensions

Even as it has embraced Air-Sea Battle, the Pentagon has struggled to explain it without inflaming already tense relations with China. The result has been an information vacuum that has sown confusion and controversy.

Senior Chinese military officials warn that the Pentagon's new effort could spark an arms race.

"If the U.S. military develops Air-Sea Battle to deal with the [People's Liberation Army], the PLA will be forced to develop anti-Air-Sea Battle," one officer, Col. Gaoyue Fan, said last year in a debate sponsored by the Center for Strategic and International Studies, a defense think tank.

Pentagon officials counter that the concept is focused solely on defeating precision missile systems.

"It's not about a specific actor," a senior defense official told reporters last year. "It is not about a specific regime."

The heads of the Air Force and Navy, meanwhile, have maintained that Air-Sea Battle has applications even beyond combat. The concept could help the military reach melting ice caps in the Arctic Circle or a melted-down nuclear reactor in Japan, Adm. Jonathan Greenert, the U.S. chief of naval operations, said in May at the Brookings Institution.

At the same event, Gen. Norton Schwartz, the Air Force chief, upbraided a retired Marine colonel who asked how Air-Sea Battle might be employed in a war with China.

"This inclination to narrow down on a particular scenario is unhelpful," Schwartz said.

Privately, senior Pentagon officials concede that Air-Sea Battle's goal is to help U.S. forces weather an initial Chinese assault and counterattack to destroy sophisticated radar and missile systems built to keep U.S. ships away from China's coastline.

Their concern is fueled by the steady growth in China's defense spending, which has increased to as much as \$180 billion a year, or about one-third of the Pentagon's budget, and China's increasingly aggressive behavior in the South China Sea.

"We want to put enough uncertainty in the minds of Chinese military planners that they would not want to take us on," said a senior Navy official overseeing the service's modernization efforts. "Air-Sea Battle is all about convincing the Chinese that we will win this competition."

Like others quoted in this article, the official spoke on the condition of anonymity because of the sensitivity of the subject.

A military tech 'revolution'

Air-Sea Battle grew out of Marshall's fervent belief, dating to the 1980s, that technological advancements were on the verge of ushering in a new epoch of war.

New information technology allowed militaries to fire within seconds of finding the enemy. Better precision bombs guaranteed that the Americans could hit their targets almost every time. Together these advances could give conventional bombs almost the same power as small nuclear weapons, Marshall surmised.

Marshall asked his military assistant, a bright officer with a Harvard doctorate, to draft a series of papers on the coming "revolution in military affairs." The work captured the interest of dozens of generals and several defense secretaries.

Eventually, senior military leaders, consumed by bloody, low-tech wars in Iraq and Afghanistan, seemed to forget about Marshall's revolution. Marshall, meanwhile, zeroed in on China as the country most likely to exploit the revolution in military affairs and supplant the United States' position as the world's sole superpower.

In recent years, as the growth of China's military has outpaced most U.S. intelligence projections, interest in China as a potential rival to the United States has soared.

"In the blink of an eye, people have come to take very seriously the China threat," said Andrew Hoehn, a senior vice president at Rand Corp. "They've made very rapid progress."

Most of Marshall's writings over the past four decades are classified. He almost never speaks in public and even in private meetings is known for his long stretches of silence.

His influence grows largely out of his study budget, which in recent years has floated between \$13 million and \$19 million and is frequently allocated to think tanks, defense consultants and academics with close ties to his office. More than half the money typically goes to six firms.

Among the largest recipients is the Center for Strategic and Budgetary Assessments, a defense think tank run by retired Lt. Col. Andrew Krepinevich, the Harvard graduate who wrote the first papers for Marshall on the revolution in military affairs.

In the past 15 years, CSBA has run more than two dozen China war games for Marshall's office and written dozens of studies. The think tank typically collects about \$2.75 million to \$3 million a year, about 40 percent of its annual revenue, from Marshall's office, according to Pentagon statistics and CSBA's most recent financial filings.

Krepinevich makes about \$865,000 in salary and benefits, or almost double the compensation paid out to the heads of other nonpartisan think tanks such as the Center for Strategic and International Studies and the Brookings Institution. CSBA said its board sets executive compensation based on a review of salaries at other organizations doing similar work.

The war games run by CSBA are set 20 years in the future and cast China as a hegemonic and aggressive enemy. Guided anti-ship missiles sink U.S. aircraft carriers and other surface ships. Simultaneous Chinese strikes destroy American air bases, making it impossible for the U.S. military to launch its fighter jets. The outnumbered American force fights back with conventional strikes on China's mainland, knocking out long-range precision missiles and radar.

"The fundamental problem is the same one that the Soviets identified 30 years ago," Krepinevich said in an interview. "If you can see deep and shoot deep with a high degree of accuracy, our large bases are not sanctuaries. They are targets."

Some critics doubt that China, which owns \$1.6 trillion in U.S. debt and depends heavily on the American economy, would strike U.S. forces out of the blue.

"It is absolutely fraudulent," said Jonathan D. Pollack, a senior fellow at Brookings. "What is the imaginable context or scenario for this attack?"

Other defense analysts warn that an assault on the Chinese mainland carries potentially catastrophic risks and could quickly escalate to nuclear armageddon.

The war games elided these concerns. Instead they focused on how U.S. forces would weather the initial Chinese missile salvo and attack.

To survive, allied commanders dispersed their planes to austere airfields on the Pacific Islands of Tinian and Palau. They built bomb-resistant aircraft shelters and brought in rapid runway repair kits to fix damaged airstrips.

Stealthy bombers and quiet submarines waged a counterattack. The allied approach became the basis for the Air-Sea Battle.

Think tank's paper

Although the Pentagon has struggled to talk publicly about Air-Sea Battle, CSBA has not been similarly restrained. In 2010, it published a 125-page paper outlining how the concept could be used to fight a war with China.

The paper contains less detail than the classified Pentagon version. Shortly after its publication, U.S. allies in Asia, frustrated by the Pentagon's silence on the subject, began looking to CSBA for answers.

"We started to get a parade of senior people, particularly from Japan, though also Taiwan and to a lesser extent China, saying, 'So, this is what Air-Sea Battle is,'" Krepinevich said this year at an event at another think tank.

Soon, U.S. officials began to hear complaints.

"The PLA went nuts," said a U.S. official who recently returned from Beijing.

Told that Air-Sea Battle was not aimed at China, one PLA general replied that the CSBA report mentioned the PLA 190 times, the official said. (The actual count is closer to 400.)

Inside the Pentagon, the Army and Marine Corps have mounted offensives against the concept, which could lead to less spending on ground combat.

An internal assessment, prepared for the Marine Corps commandant and obtained by The Washington Post, warns that "an Air-Sea Battle-focused Navy and Air Force would be preposterously expensive to build in peace time" and would result in "incalculable human and economic destruction" if ever used in a major war with China.

The concept, however, aligns with Obama's broader effort to shift the U.S. military's focus toward Asia and provides a framework for preserving some of the Pentagon's most sophisticated weapons programs, many of which have strong backing in Congress.

Sens. Joseph I. Lieberman (I-Conn.) and John Cornyn (R-Tex.) inserted language into the 2012 Defense Authorization bill requiring the Pentagon to issue a report this year detailing its plans for implementing the concept. The legislation orders the Pentagon to explain what weapons systems it will need to carry out Air-Sea Battle, its timeline for implementing the concept and an estimate of the costs associated with it.

Lieberman and Cornyn's staff turned to an unsurprising source when drafting the questions.

"We asked CSBA for help," one of the staffers said. "In a lot of ways, they created it."

Julie Tate contributed to this report.

As China spends more on defense, U.S. military studies its options

Wash
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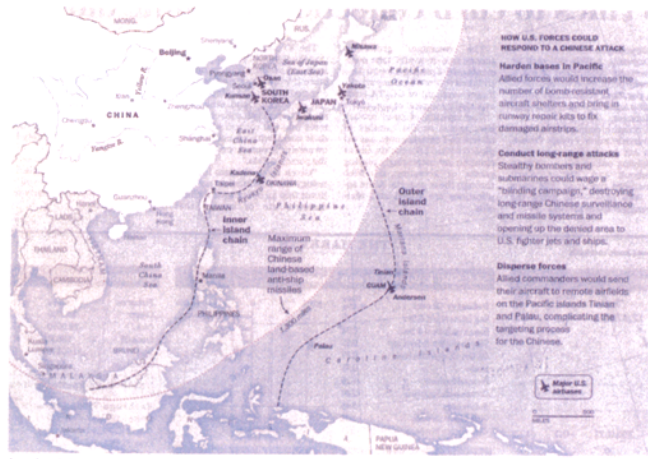
What is Air-Sea Battle?

China has invested heavily during the past decade in precision missile systems and sophisticated radar designed to keep U.S. ships and fighter jets beyond the inner island chain shown below. Air-Sea Battle is the U.S. military's concept for disabling those systems using long-range bombers and submarines. The

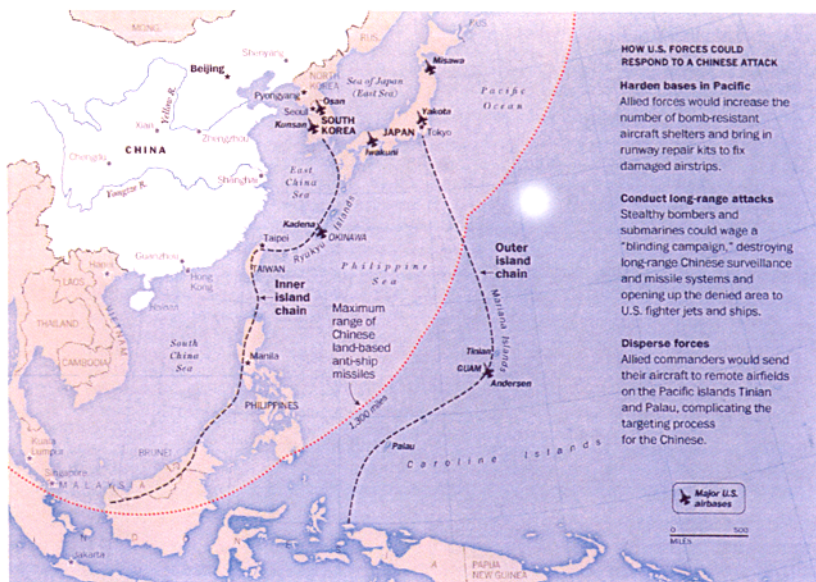
concept is designed not so much to fight a war as to convince the Chinese that any conflict with U.S. forces would be long and costly. Pentagon officials say Air-Sea Battle is not solely focused on China, which they describe as the "pacing" threat. The following approaches are the basis for the concept:

and attack.

To survive, allied commanders dispersed U.S. bases to ensure airfields on the Pacific islands of Tinian and Palau. They built bomb-resistant aircraft shelters and brought in rapid runway repair kits to fix damaged airstrips.



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Ms. BORDALLO. Thank you. Secretary Kagan, I have a question for you, the Palau Compact adjusted certain amounts of U.S. assistance over time to split the cost of the diminished value between the U.S. and Palau. Now this was prudent for a measure that determines assistance for a long period of time. The Republican Congress in 2003 expanded the adjustment in the negotiated revised Compacts with the other two freely associated states. However, H.R. 6040 only includes the partial adjustment factor included in the Compact with Palau.

The Economist cited by the GAO has calculated that the cost would be less than \$1 million a year, using the CBO formula. This is intended by H.R. 6040 to be more than made up by the bill's cost offset. Congress urged the Administration to include a cost adjustment provision in the agreement strongly desired by Palau. The lack of such a provision casts doubt whether the agreement could have obtained Palau acceptance. Can you elaborate why the Administration didn't agree to include a cost adjustment provision in the agreement, especially after Congress added one in 2003, and Congress said one would be needed?

Mr. KAGAN. Thank you, Madam Bordallo. Thank you very much for the question, Madam Bordallo. I think this goes back to what we discussed before, which is that the overall package which was negotiated between the United States and the Government of Palau was one that was carefully calibrated to address a variety of concerns as was foreseen in the original 15-year review period. We believe that the resulting agreement is one that accurately reflects the changes in Palau and is one that has been accepted by both governments. We obviously believe that the Government of Palau supports this agreement and are confident that once there is action in the United States that we are confident that Palau will accept it.

As to the intent, I think the reason was that there was a feeling that Palau circumstances had evolved to a point where this approach now was appropriate. Clearly, our goal in doing negotiations was to safeguard broader U.S. interests, including trying to ensure the appropriate compensation was provided to Palau under the terms of the agreement. Now obviously, this is something that it reflects the different circumstances that prevailed with the other Compact states, but we believe this is one that is appropriate and is fair.

Ms. BORDALLO. You say the Palau government agrees?

Mr. KAGAN. Yes, the Palau government agrees.

Ms. BORDALLO. This could be Secretary Babauta or Secretary Kagan, we all know that Palau is an important strategic ally to the United States. We should remember the thousands of Americans paid the ultimate sacrifice to free Palau from Japanese rule. The Compact about the security of America in the Pacific region, in the Asia-Pacific region, this capability directly aligns with the President's broader, military diplomatic strategy for the region. So my colleagues and I want to get a Palau Compact passed. Can we expect engagement from the Administration on offset so that we can pass this Compact during this Congress? Also, with the delays in passing the Compact, what message does that send to our allies in

the region? And what diplomatic or political capital have we lost in not passing the agreement?

Mr. KAGAN. Again, thank you very much for the question which I think goes to the very heart of the why the Administration very strongly supports prompt action to pass the Compact, the extension. We believe that failure to move forward has significant costs not just for our relationship with Palau, but in a region where people look very closely at how we treat our friends. So I fully agree with you and fully agree with Mr. Faleomavaega before that about the need for prompt action. We stand ready to engage and engage very actively to find appropriate offsets, I believe we have done that and we will continue to do so.

Ms. BORDALLO. I did ask do you think it will be passed during this Congress?

Mr. KAGAN. It is not for me to speak as to what the Congress will do.

Ms. BORDALLO. Would you be ready?

Mr. KAGAN. We stand ready to engage, we strongly support prompt action and will do whatever we can to support it.

Ms. BORDALLO. Thank you. Mr. Chairman, are we going to have a second round on this?

Dr. FLEMING. Indeed.

Ms. BORDALLO. Good. I yield back.

Dr. FLEMING. The gentlelady yields her time back. I think our panel seems up to it, so we will begin our second round here. You can tell this is all very engaging and important information.

Secretary Kagan, both Mr. Sablan and Ms. Bordallo raised concerns, time not included in the Compact, for H.R. 6040. Are the annual audits, inflation rates and U.S. Postal Service's subsidy language being tied to national rates? The added benefits you mentioned in your testimony. Are these the only added benefits? Tell us more about that. Can you expand upon that because obviously there are a lot of questions about that in the hearing?

Mr. KAGAN. Certainly, Mr. Chairman. As you said, we welcome this opportunity to engage and discuss because we recognize that your role in this is critical and we want to try to be as supportive as possible.

I think that our position is this was very painstakingly negotiated. As I said, there is a balance between the different elements. Both sides had to give as well as take. I think our view is we strongly object to Section 105(e)3.

We made a deliberate decision to negotiate the compact review agreement as an amendment for several reasons. And one of these had to do with the desire not to extend the full faith and credit of the United States the obligations contained in the Compact. We believe that this is something that is very much in our interest. We do look forward to a continued discussion on this.

We also object to the application of Section 215 of the Compact to the funding commitments in the agreement on the partial inflation adjustment.

I think that this is in part because of the higher total dollar costs and also in part because, again, of maintaining the balance within the different elements of the Compact.

Dr. FLEMING. Let me interrupt you because we are all limited in time.

So, in answer to my question, you read me language from the bill. I just want to get clarification here. These three things: Inflation adjustments; tie the U.S. Postal Service subsidy to retaining domestic U.S. postal rates; and require the U.S. to pay for annual audits. Do you support that? Does the Administration support that or not?

Mr. KAGAN. Our view is we do not support the inflation adjustment. I defer to my colleague, Assistant Secretary Babauta on the postal rates. And on the audits, we believe that this is fair and appropriate and support the idea of transferring the financial responsibility for this to Palau. But again, we stand ready to remain engaged with the Committee because our goal is to reach prompt agreement so that we can have prompt action to pass the legislation.

Dr. FLEMING. Mr. Babauta.

Mr. BABAUTA. Mr. Chairman, I join my colleague, Mr. Kagan, on his thoughts with respect to the audit and who is going to pay for the cost of the audit. That is something I am trying to recall the negotiations themselves in Hawaii, where I was present, exactly why it fell on Palau, and we are happy to get back to you on exactly why that happened. An inflation adjustment wasn't part of the finalized negotiated agreement with Palau, and the language that is referenced in H.R. 6040, which was amended by the Foreign Affairs Committee, the renegotiated agreement with the RMI and the FSM also did not contain the inflation adjustment, as Mrs. Bordallo points out, when it was submitted to Congress for consideration. And however, we recognize that Congress saw fit at the time to include such language in the RMI and FSM agreement.

Dr. FLEMING. I got that you don't support that. But what about the postal rates and the audits?

He was deferring to you on that.

Mr. BABAUTA. I join him in support of the audits.

On the postal rates, the postal rate was something internal for us to negotiate on the U.S. side. And that was reflected eventually in the finalized negotiated agreement. There is nothing that we are subsidizing within the Postal Service that takes away from the substance and the financial assistance that we are going to give to Palau.

Dr. FLEMING. So, of these three items, and again I am going to have to get a little more clarification as to what the answers are on it, what the Administration supports or what it doesn't, but had these been agreed to by Palau? That is the question.

The Administration's position on these three items, have they been agreed to by Palau?

Mr. KAGAN. Yes. This was agreed to and reflected in the final agreement between the Government of the United States and the Government of Palau.

Dr. FLEMING. All right. Thank you, gentlemen. I yield back.

Ranking Member, Mr. Sablan.

Mr. SABLAN. Thank you very much, Mr. Chairman, and let me also go back, but again, Secretary Kagan, let me ask you two questions, and I need a short response.

What is the significance of Palau in the U.S. national security interests in the Pacific?

Mr. KAGAN. We believe Palau is critical for two reasons. One is that it is a very strategically located piece of real estate that also has a very important economic, exclusive economic zone and that the Compact which provides us responsibility for security and defense of Palau also provides us very critical access for our military forces and the ability to deny such access to foreign military forces.

The second is Palau is a very close friend and ally and supporter in a lot of different areas, including the United Nations but also in the Pacific, and has been a very critical supporter of our enhanced engagement in the Pacific in the past 3 years.

Mr. SABLAN. Thank you. And also let me ask who among all our friends in the world were the first to take the Uyghur prisoners from Guantanamo Bay?

Mr. KAGAN. I believe that we negotiated agreements with Bermuda and Palau.

Mr. SABLAN. My question is who not—

Mr. KAGAN. Palau and Bermuda.

Mr. SABLAN. Palau, right?

Mr. KAGAN. Yes.

Mr. SABLAN. And then we nickel and dime them in negotiations for the compact financial? That is how we treat our friends?

Please I am Micronesian. I know how we have been treated. I grew up with people from Palau. We nickel and dime our very best friends, Mr. Kagan. I am not being disrespectful here. I am just being truthful here, what we are worried about is \$500,000; we are worried about subsidies. I think the Assistant Secretary will take care of the subsidy. But is this how we treat our friends? Is this how we want to be known in the world as how we treat our friends?

Mr. KAGAN. Mr. Sablan, I appreciate very much the question. I appreciate it, and I think that the fair response to that is that we went into this with the desire to enhance and strengthen the Compact. We wanted to reflect the different circumstances that prevailed. I do not believe we nickel and dined our friends. I believe that what we did was try to negotiate something that we believed was fair for the people of Palau and fair for the people of the United States.

Mr. SABLAN. But, as you said earlier, Secretary Kagan, and I am not being, I hope you don't take this as being disrespectful—maybe I am a little passionate—but you would not recommend the Administration does not allow this to go into law, the Congress approves the legislation that is before us. You would be—you wouldn't say object to it and say it is not good.

Mr. KAGAN. I think we would want to try and work with you very respectfully to try and address our concerns. But we strongly support prompt passage of this legislation.

Mr. SABLAN. Two years and 1 week, Mr. Secretary, and we still don't have an offset that Congress agrees to, and this is, working with you, sir, is the language that means a sense of Congress. But anyway, I will work you with also, Mr. Secretary.

Dr. Gootnick, now for the difficult questions, sir, I hope not. Of the \$189 million remaining to be provided, because I think the \$26

million has been appropriated already, isn't \$30 million to make up for the initial U.S. underfunding of the Compact Trust Fund to enable it to provide the revenue it is supposed to provide through the 50 years of U.S. military base rights under the Compact? And isn't \$28 million for maintenance of infrastructure that the U.S. considered essential?

Mr. GOOTNICK. Yes, to your first question, you are correct. The \$30 million plus-up is intended to support the trust fund to better its prospects to get to 2044. So the agreement, the Palauans agreed to reduce their withdrawals from the trust fund in the short term, plus it up toward the end of this 15-year period to the \$15 million but from there on out through 2044 to yield \$15 million.

I would point out that is also not inflation adjusted \$15 million. So, by the time you get out to 2044, that \$15 million looks quite different.

With respect to the infrastructure maintenance fund, the fund stipulates that the priorities are to U.S.-funded projects, so that is the Compact road first and foremost but, in addition, improvements to the international airport.

Mr. SABLON. My time is up, Mr. Chairman. I hope there is another round of questioning.

Dr. FLEMING. The gentleman yields his time back.

The Chair recognizes Mr. Faleomavaega for 5 minutes.

Mr. FALEOMAVAEGA. Thank you, Mr. Chairman.

Secretary Kagan, from what I am hearing in your testimony, you are suggesting that the Administration is going to recommend a veto of this proposed bill H.R. 6040?

Mr. KAGAN. As I have said, we look forward to working very closely with Congress on prompt passage of this legislation. I think it would be inappropriate to speculate on what our position would be until we see the final bill.

Mr. FALEOMAVAEGA. Not to speculate, let me just give you a little sense of history here. This was 2 years ago, 2 years ago, Secretary Clinton wanted legislation enacted so that we could comply with the provisions of the Compact that we have agreed with the Republic of Palau. Both the Department of the Interior and State Departments did not submit a proposed bill until last year, but it didn't include offsets. And according to our House Rules, both Houses rejected what the Administration had suggested.

And now both, the Administration just has not even given any offerings in terms of what you are willing to do so we can get this thing done. And that is what forced myself and Chairman Manzullo and 14 other Members of the Congress on the Foreign Affairs Committee to propose 6040, so we could go through this impasse.

Now you say you are willing to do this, but for the past 2 years, Secretary Kagan, that has not been the response of the Administration. You have been kicking the can down the alley, the highway, the mountains and the ocean. I don't know what the heck is going on here. So now we find ourselves in this predicament. You say the Administration is more than willing to offer help, and we talk about these things. We are nitpicking over the assistance that Palau deserves and what we have agreed upon under the terms of the Compact.

And yet for the billions of dollars that we give in foreign aid in other countries, do we make demands such as this about audits? I don't think so.

And Secretary Babauta, I want to ask you this, you are saying that Palau agreed to these three things about the audits and about the Postal Service and about the inflationary costs? My understanding, they have not agreed unless, and that is the reason why we have these provisions added on the proposed bill.

Mr. BABAUTA. Well, during the negotiations themselves, as Assistant Secretary Kagan pointed out, issues were raised, some were accepted by Palau, some were accepted or denied by the United States——

Mr. FALEOMAVAEGA. Here is an example, Secretary Babauta, on the audit issue. It is agreed with the Republic of the Marshall Islands and the Federated States—the joint funding of the auditing. And yet under this proposal we have, you are expecting Palau to pay for the entire audit process. Is that fair?

Mr. BABAUTA. I would like to say that, during the negotiations, there was some finality to this issue, which was accepted by both parties——

Mr. FALEOMAVAEGA. Well, somebody screwed up here. Why are we treating Palau differently from the other two free states? The question of inflationary adjustment issue, this was already in the Compact, this provision about cost inflation, and you are objecting to this.

Secretary Kagan, why are you objecting to the inflationary cost provision index?

Mr. KAGAN. As I said before and as Assistant Secretary Babauta has said, this is part of a complex set of negotiations. There were trade-offs that were made, there were things that were accepted by the United States——

Mr. FALEOMAVAEGA. But why are you objecting to this inflationary index?

Mr. KAGAN. We believe that——

Mr. FALEOMAVAEGA. Too costly? Eleven billion dollars too costly for a 12-year period?

Mr. KAGAN. We have a responsibility to try and steward our funds carefully, and we believe this was part of an appropriate set of negotiations between our governments——

Mr. FALEOMAVAEGA. So, in other words, you are going to continue objecting and not even approve or have any sense of support for this proposed bill.

Mr. KAGAN. I want to make very clear that we do not object to this proposed bill, that there are certain provisions within it that we have concerns about and that we look forward to working with Congress on, but we strongly support prompt action by Congress to pass this legislation.

Mr. FALEOMAVAEGA. What kind of a time schedule are you looking at, Secretary Kagan, that we can get a firm answer from the Administration? How soon can you tell us it is yes or no, forget it, we don't support it, so we know where to go?

Mr. KAGAN. We want to make clear that we support this legislation. We believe there are elements in it——

Mr. FALEOMAVAEGA. Another 2 years?

Mr. KAGAN. We have absolutely no desire to wait. We would like to see prompt action. We recognize this is very important to the people of Palau. We have been pushing for action on this for some time, and we look forward to working with you to try and make sure that happens.

Mr. FALEOMAVAEGA. Mr. Kagan, I appreciate your comments, but it just doesn't simply add up to what we have had to endure for the last 2 years from the Administration.

Mr. KAGAN. We look forward to working with you, and we look forward to prompt action on this.

Mr. FALEOMAVAEGA. I am sorry, Mr. Chairman. My time is up. I will wait for the third round if there is a chance. Thank you.

Dr. FLEMING. The gentleman yields his time, and he predicts there will be a third round. I suspect he is right.

The Chair now recognizes Ms. Bordallo for 5 minutes.

Ms. BORDALLO. Thank you, Mr. Chairman.

Secretary Babauta, I am going to add to my colleague's comments from American Samoa. He mentioned different concerns, and when is this U.S. Postal bill—Service—have Palauans expressed substantial concern about the cuts in and increased costs for the U.S. Postal Service delivery of mail to the islands under the agreement?

Just a direct question. Have the Palauans expressed concern? And further, are you aware of appropriations for a subsidy to the U.S. Postal Service for mail to independent countries which requires international rate postage?

Mr. BABAUTA. I believe, yes, Palau has expressed some concern over the subsidy of the Postal Service. It is within the renegotiated agreement.

And to your second question, no, I am not aware of any subsidy that is provided to—

Ms. BORDALLO. You might check on that.

Secretary Kagan, I wanted to ask, following up on Congressman Faleomavaega's questions, what are your concerns on this legislation? Could you point them out? The biggest concerns you have? And there must be two or three that you are really stuck on in these negotiations.

And again, I will ask the question that I asked earlier, will you be ready to present this to Congress?

Mr. KAGAN. I think we have identified the concerns.

Ms. BORDALLO. Before the end of the year?

Mr. KAGAN. The answer on your final question is yes. We strongly support prompt action.

Ms. BORDALLO. But you have concerns.

Mr. KAGAN. We have some concerns on some specifics. We think they are relatively minor and can be very easily addressed.

Ms. BORDALLO. Could you mention those minor concerns?

Mr. KAGAN. Well, I think, very specifically, the one has to do with the full faith and credit of the United States. As my colleague has mentioned, this was not something that was extended to the other Compact states as part of the 2004 amended Compacts.

And then the other concern has to do with the inflation adjustment. And we believe that it is very much in our national interest to try to stick to the overall dollar amounts that were negotiated.

But I think that fundamentally, our strongest concern is prompt passage of this legislation, so we can keep our faith with the people and the Government of Palau.

Ms. BORDALLO. I have another question for you, Secretary Kagan.

A major stated goal of the agreement in the negotiations was to phase out Palau's dependence upon U.S. assistance for essential services provided by the Government of Palau.

Would any of the provisions of H.R. 6040 run counter to that goal of the Administration in the negotiations?

Mr. KAGAN. Not to the best of my knowledge. I would defer to my colleague, Assistant Secretary Babauta, who is more familiar with the specific details of how the Compact assistance works.

Mr. BABAUTA. Congresswoman, I don't believe any of the goals that are in the renegotiated agreement run counter, generally, to our goals for Palau, which is to continue to see them grow, to be able to assist them in providing funding for education, public health, public safety, which are all elements of the negotiated agreement.

Palau and the United States were very specific with respect to the U.S. assistance that is going to go out there. It is going to be used for those areas only. It will not be used for the president's office. It will not be used by the OEK nor by the judiciary.

The U.S. funding is going to go straight in to the programs that are provided to the people of Palau.

Ms. BORDALLO. Thank you.

Thank you, Mr. Chairman. I yield back.

Dr. FLEMING. The gentlelady yields back.

OK, we shall begin a third round, and we thank you gentlemen for hanging in there.

Let me see if I can kind of bring some clarity to this discussion, begin to tie some things together. We are all, I think, on very similar tracks here.

The whole idea behind the continued funding for Compacts and really other island situations—I mean, since I have been Chairman of insular affairs, this seems to come up constantly—and that is, how do we wean countries off of dependency by creating an economy on island that will sustain that island into the future? Part of this idea, of course, was to create a trust fund, but unfortunately, the return on investment is a little low right now, so that is a problem.

So my question, I really have two questions, and certainly any of you on the panel are welcome to take a stab at this, is, number one, what are we doing to get that GDP up higher?

What other sources, private economy, whether it is through bringing more visitors to the island, more commerce, are there other lines of economic growth that we can pursue, and the other is it really seems like to me there is only one real major sticking point here and that is the pay-for. And so I would love to have your response on both of these questions.

Where do you think we are going GDP wise? How are we going to fix it in a way where this is going to be less and less an issue in the out years?

And then number two, how we can we get past this pay-for issue?

Mr. BABAUTA. Thank you very much, Mr. Chairman.

With respect to the first part of your question, during the negotiations themselves, the agreement has created an advisory group on economic reform, which will be comprised of both members from the United States and Republic of Palau. That group will meet annually and determine, make recommendations on reforms that need to occur within government and reforms that need to occur economically so that you are building, so you are continuing to have your economy grow. There is language in there that—

Dr. FLEMING. In real terms, though, do we have anything more than tourism that we are working with here?

Mr. BABAUTA. Tourism is the largest part of their economy, sir.

Dr. FLEMING. Is there agriculture, natural resources?

Mr. BABAUTA. They are a haven for how they conserve their resources, and that is partly why their tourism is as it is, it is because of their conservation—

Dr. FLEMING. By natural resources, I mean any type of mining or perhaps fisheries, anything else that could utilize natural resources?

Mr. BABAUTA. Fisheries, again, is a huge resource for them. I can ask Mr. Kagan to speak about that since this is an issue that is kind of more at the forefront.

Dr. FLEMING. What can you tell us about the pay-for? Where can we get past the stumbling block that we are at with the pay-for?

Mr. BABAUTA. The Department of the Interior and the OMB have identified several offsets, as you know. Alternative offsets have been developed by the House Foreign Affairs subcommittee which are incorporated into H.R. 6040, and in principle, we have no objection to the offset identified by the Foreign Affairs Subcommittee on Asia and the Pacific Islands in their version of H.R. 6040 that was marked up on July 18th and have been working with that subcommittee to modify the language for State Department purposes.

The final language, of course would need to be reviewed by our OMB process, however, to ensure that equities of all Executive Branch agencies are safeguarded.

Dr. FLEMING. So, basically, what you are saying is that these various departments are working with our Committees, and we continue the discussions, but, and you do support the latest version, the latest iteration. Although we have a problem on our side with that, obviously, which is I guess the reason why it is not moving forward, and that is the passport and the taxation issue. So your department supports that in theory; really the problem is internally here in Congress, is that correct? Am I correct about that?

Mr. KAGAN. To be clear, we have no objection to it, and we have engaged with the Committee staff on the details of it.

There are some specific details on how it would be applied that are of some concern to the State Department but that are very technical in nature and which we believe should be fairly easy to address. We recognize that this is obviously a critical piece of moving this forward, and we appreciate the leadership the Committee

has taken to try and find an appropriate offset that would allow this to move forward.

Dr. FLEMING. Can you follow up on the passport issue? Can you provide the language to the Committee that we need that would make that acceptable, the passport taxation issue?

Mr. KAGAN. Certainly, we are prepared to continue engaging on that, and I think, as we have told Committee staff, we have I believe four specific concerns that are very technical in nature on how that would be applied.

Dr. FLEMING. Yes, if you would get us the language, that would certainly be appreciated.

I yield back and recognize Mr. Sablan for 5 minutes.

Mr. SABLAN. Thank you very much, Mr. Chairman.

Secretary Kagan, I want to thank you, sir, for being engaged in this issue. Obviously, for us, sometimes it is not fast enough, but I know you are very engaged, and I appreciate your taking the time to fly to and go to Palau before Chairman Fleming did, and I have been inviting him since forever. But thank you, sir, for what you are doing, and I do have some questions that I would eventually like you to respond to.

Dr. Gootnick, it is always nice to see you, sir. It is always good to see you. I also have questions that we will submit to you and get a response.

Of course my favorite, Secretary Babauta, sir, thank you for many things that you do for Palau, for the Northern Marianas in particular, and I am sure for the other territories and Micronesia and the Pacific.

But I do have some questions, Mr. Secretary.

I hope that we could work out also the U.S. Postal Service means of delivering packages because this is truly important for my constituents because if we have to pay international to ship to Palau or pay international, you know those betel nuts that they ship from Palau to the Northern Marianas, trust me, I would have constituents knocking on my door about this issue. But we really appreciate the time that you are going to work on this, we are going to try and work together on the postal delivery issue so we can pay domestic rather than international rates, and I will work with you, sir.

But let me ask you a question before I get to my other issue. How does the new agreement affect the Compact trust fund, in your own opinion, sir?

Mr. BABAUTA. Well, it affects it in many ways. It strengthens the Compact trust fund; it makes it so that we are making investments throughout the life of the second term of the Compact, so that, at the end of that term, it can provide the \$15 million that is needed after U.S. assistance ends.

Mr. SABLAN. Why does the agreement deny the use of funding by the offices of the President, Palau's congress, because I can't say the Palau name, I apologize to the Ambassador, Palau's congress, judiciary and state governments; was there a problem with Palau's use of earlier resources?

Mr. BABAUTA. There was no problem. I think it is simply a reflection of the fact that Palau believes that for those branches of government, the president or those offices of the presidency, the OEK,

and also the judiciary, that that should be funded by local funds generated by their own revenue and not with U.S. assistance. They believe, as does the U.S., that U.S. assistance should be going directly to programs, such as education, health care and public safety.

Mr. SABLAN. Thank you. Now since we are talking about money, Mr. Secretary, let me just shift our attention to the Northern Mariana Islands.

As you know, sir, the Commonwealth is in deep financial trouble. Our retirement fund, a United States District Court judge had to— is considering and will make an appointment of ad litem trustees because my Governor refuses to provide trustees for a quorum because he has issued an emergency order that he would seize the money for the retirement fund, for the pension fund.

We have a hospital, sir, where there is a child, a young child, who is being fed through a tube and the hospital cannot even buy her the Pediasure and the remaining supply of tube that feeds her is actually the one in her body, and that people in the committee are now chipping in, so that they could provide and make sure this little girl survives. Her name is Dora. Where our Governor has terminated a very capable executive director of the Commonwealth Utilities Corporation because he said that this guy wasn't doing enough for alternative energy and then turns around and signs a 25-year, \$190 million plus plus plus deal for fossil fuel. It is all about the money problem.

His use, emergency after emergency—and recently, sir, your office paid for a fiscal study of the Commonwealth government apparently to get a better picture of what is going on. This document has not been made public. I got three pages of the report dealing with education. And obviously, I am very concerned because education is my number one agenda in Congress. We are spending less per capita in education than any other U.S. insular area.

You are aware of this Federally funded report?

Mr. BABAUTA. Yes, sir.

Mr. SABLAN. May I have a copy, please?

Mr. BABAUTA. Absolutely, Congressman. Right now, it is in draft form. We did this, we entered into kind of an arrangement with the Governor of CNMI about 4 months ago where our current contract with a graduate school, we used that to help assistance the CNMI and assist us in identifying exactly how their cash flow is laid out, how they are collecting revenue, and how they are spending their money. I have it in draft form right now. As soon as it is finalized, I will have my office come up, and we will brief you about it.

Mr. SABLAN. Do we have any idea when? Are you waiting for—from what I understand, you are waiting for the Governor to say OK you can release it, right?

Mr. BABAUTA. Absolutely not, sir.

Mr. SABLAN. Any idea when you are going to release this, Mr. Secretary? Because the problem is the money. We need to know why and where it is going.

Mr. BABAUTA. I will follow up when I get back to the office. I have seen it in draft form. Let me figure out exactly when we predict that it is going to be in the final form. But I can't imagine it will take more than a week or two to become final.

Mr. SABLAN. Thank you very much, Mr. Secretary, and again, thank you, sir, for all that you do. I appreciate it.

Secretary Kagan, please know I appreciate your engagement.

Dr. Gootnick, it is always good to talk to you, sir, and get some—and differentiate unbiased opinion on several of the things going on. I appreciate it.

If there is another round coming, I will ask my questions. But for now, I yield my time.

Dr. FLEMING. The gentleman yields back.

Mr. Faleomavaega has taken a couple of deep breaths.

Mr. FALEOMAVAEGA. Mr. Chairman, I do want to say it is not every day that when having a congressional hearing, you get three rounds of questioning, but I deeply appreciate your patience and your forbearance in allowing us to continue the dialogue with our friends here from the Interior Department and also from the State Department.

Again, I want to ask Secretary Kagan, Chairman Manzullo and I have had to search wide and low and whatever you want to call it trying to figure what would be a possible offset because apparently, the recommendations of offsets of both the Interior and State Department recommended were not acceptable to both Houses, the Senate as well as in the House.

So, now, Chairman Manzullo and I thought, well, why do we have this offset dealing with passports? The flow or the stream of revenues that we gain from passports is well over \$400 million a year. And what we are asking for here for this 10-year period that we are looking at the bill, that we are looking at about \$183.5 million for a 10-year period from 2013 to 2022 or also, in addition, to \$189 million if you add \$6 million for infrastructure, maintenance as well as government operations.

What I wanted to do is just to get a sense from you what—I guess, we have to put ourselves in the footings of the Palauans and their leaders. Supposing that we don't approve this bill, no money comes to Palau; if you were a Palauan, what would you think your reaction is going to be to that effect? This small little tiny country, a lot of coconuts and coconut crabs and all of this and think of it as a little silly island community out there in the middle of nowhere, which is only about the size of Texas if you want to put in economic zones and the ocean, but what do you suppose is going to be the reaction to the Palauan leaders if we don't honor our obligations and commitments under the provisions of the Compact?

I had mentioned earlier in my statement, I think we do have an obligation under the Full Faith and Credit Clause of the Constitution to pay the Palauans what we do because what are we getting in exchange? Usage of Palauan waters and their resources in time of a national emergency in terms of whether or not we determine this area to be important as far as strategic and military interests are concerned, and we are funding, we are paying billions of dollars in what we do there as far as defense issues are concerned, and we are talking about \$183 million, \$184 million billing for a 10-year period, and we can't even find a stream of revenue to pay for this.

I am not suggesting that \$183 million is peanuts. But when compared to the billions and billions of dollars that we give to foreign countries that we can't even audit, and here we are diming and

nickeling or nickeling and diming for this amount for this country that really needs the resource.

Mr. Kagan, how soon will we get an answer from the State Department whether or not they will support this bill? Because we really need to know where the Administration's position is on this.

Mr. KAGAN. Congressman Faleomavaega, again, I thank you for your leadership and particularly your very wise counsel and advice, which has been one of the reasons why we have significantly stepped up our engagement in the Pacific in the past 3½ years, including Secretary Clinton's meetings with the Pacific leaders on the margins of the U.N. General Assembly—

Mr. FALEOMAVAEGA. Mr. Secretary, you are not answering my question. How soon can we get a response to this bill? With all due respect, I admire Secretary Clinton's trip to the Cook Islands and the foreign countries, all of that is nice and well. But I am talking about the needs of Palau, and we are not meeting these obligations. How can soon can we get a commitment from the State Department whether or not they support this bill?

Mr. KAGAN. I was just informed that we have provided alternative language on the offsets to the House Foreign Affairs Committee. We strongly support prompt action on this legislation. We, as I said, we believe there is appropriate room to continue engaging in some of the details, but I think I want to make very clear that we strongly support prompt action to fulfill our obligations toward Palau.

And as to your question on how they would feel, I think we feel very strongly. This is why we are looking for action on this because we recognize that failure to move quickly will have significant ramifications, not just for our relationship with Palau but also for the standing of the United States in the region.

Mr. FALEOMAVAEGA. Secretary Babauta, how soon can we get the response from the Interior Department concerning this bill?

Mr. BABAUTA. We strongly support the enactment of the pending legislation that comprises the negotiated agreement with Palau.

Mr. FALEOMAVAEGA. What does that mean? Two weeks? Three weeks? A month? How soon can we get a commitment from the Administration, the Interior Department? I mean, look, we have been dallying with this thing for 2 years now and the last thing I want to hear is that we are going to run through this cycle again for another 2 years before we finally get a commitment from this Administration on this.

Mr. BABAUTA. Congressman, this is the second time that I have testified on this bill, once in Senate and once now here. I have had staff testifying in front of your Committee. We strongly support the legislation and with regard to the new offsets that have been identified by your subcommittee, I said that we agree in principle, we know that our colleagues at the State Department are working with your Committee over at Foreign Affairs to fine tune some technicalities—

Mr. FALEOMAVAEGA. What are the technicalities? I hear both of you gentlemen saying "technicalities."

I would like to respectfully request, Mr. Chairman, I would like to request that both gentlemen submit to this Committee these technicalities they keep talking about that makes it so complex, the

issue that is now before us. But I know my time is way over, Mr. Chairman, so I yield back.

Dr. FLEMING. The gentleman's time is expired. But quite frankly, we have some more questions, so if you would like an opportunity in a moment, you will get that opportunity.

Ms. Bordallo, 5 minutes.

Ms. BORDALLO. Thank you.

Thank you Mr. Chairman.

I also want to thank the three witnesses today. It has been quite a grilling afternoon to Secretary Babauta, Secretary Kagan and Mr. Gootnick.

I think what I want to say is that the Compact ended in 2009; is that correct? And we are still 3 years later negotiating over current problems that we don't all agree on.

Now I have been questioned by the President of Palau and other leaders of Palau to please, please, help in speeding the negotiations up. So the people of Palau are becoming very frustrated. And I think it is really up to us to be able to speed this up, now that the offsets offered by Mr. Faleomavaega and his committee, but so far, from the three of you, particularly Secretary Babauta and Kagan, we don't have any concrete time, and I realize that is difficult for you to speak about. You can't really say, well, on this particular date, it is all going to be concluded, but 3 years is a long time. Like I say, the people of Palau are becoming very, very concerned about this.

So when you go back to your desks, I sure hope that you are going to keep it a top priority and be able to do something about it. But I do thank you for answering our questions this afternoon. But we, too, are very frustrated, and we want this to be concluded.

And I would like to, Mr. Chairman, yield the rest of my time to my colleague from American Samoa because he said earlier he has 100 questions.

Mr. FALEOMAVAEGA. I thank the gentlelady for yielding her time to me.

And I want to make sure the record reflects this, Mr. Chairman, that this is not a personal vendetta against Secretary Kagan or Secretary Babauta. They are both friends.

I think we need to look at the situation, Mr. Chairman, and our friends who are testifying before us this afternoon. It is not about the money that I am the concerned about, gentlemen; it is the principle. It is the principle, the fact that this great Nation, the most powerful country in the world, has made a commitment in writing, a Compact, a treaty relationship, whether it be with 15,000 people or 14 million people, the principle involved here that I am concerned about, and as I have said and it has been my criticism publicly for all these years, as a matter of our basic foreign policy to this region, we have no policy. Secretary Kagan, we have no policy. Our basic foreign policy toward this region is actually toward New Zealand and Australia.

So treaty countries like Palau or the Marshalls or FSM are only incidental if it really comes to our attention to such an extent. By the way, the South China Sea crisis and the situation now definitely is going to impact and has serious implications in terms of how these Micronesian entities currently have their relationship

with the United States, Palau being one of them, the size of Texas. And if we are really serious about our strategic and military interests, that maybe we are inviting the Palauans to shop somewhere else if the United States really has no interest in developing this close relationship.

And I will say that the opportunities that I have had in discussing these issues with the President of Palau, he is very concerned, and he is a very strong supporter of the United States, but the opposition and those who are not necessarily favorable to us are simply saying, the United States doesn't care about us, so why should we care about them? We might as well break the Compact, let's go have relations with other foreign countries that really will address more seriously our interests. Because we are not doing it.

A couple years ago, Mr. Chairman, we just forgave Jordan's \$500 million debt that they owed to this government. And let's talk about billions of dollars that we have forgiven debts in other foreign countries—billions—I am not talking about millions—billions of dollars. And here we are haggling over \$183 million for a 10-year period that we should be funding because it is part of our treaty agreements with this country. This is where I am really concerned about gentlemen. It is not the money; it is the principle that I am very concerned about.

And with that, Mr. Chairman, I thank the gentlelady again for yielding her time.

Dr. FLEMING. The gentlelady yields her time back.

Rather than go another round, what the Chair would like to do is simply to ask another question or so that may be left. I think we have covered just about everything. I know I have one question, and then I will open it up for other members of the panel who would like to ask a final question.

My question, gentlemen, is back to H.R. 6040. Are there conditions in which the money would be provided, should we get it passed and find a pay-for, that are benchmarked on certain factors, certain economic issues, achieving certain benchmarks economically along the lines of what we have talked about, tourism and other things, are there such benchmarks, conditions, and what are they in a general way?

Mr. BABAUTA. Certainly, there will be benchmarks. There aren't any current benchmarks where, that I recall that we are going to begin with. The meeting that we will have, after the Compact is passed, the advisory group on economic reforms, will take into consideration reports that have already been issued about economic reforms that need to take place that are Palau specific. Economic reforms, changes in government, some of those reports have been generated by the IMF and by the ADB. I think, in short measure, that will help initially guide the group as it moves forward and makes recommendations to put the Palauan Government itself on what reforms need to take place. I think that is where we are setting benchmarks.

Dr. FLEMING. Thank you and to follow up, does the full faith and credit language included in H.R. 6040 affect the ability of the Department of the Interior to withhold funds to insist on economic and financial improvements by Palau? I am sort of restating the

question but in a more formal way. Again, back to the full faith and credit language.

Mr. BABAUTA. I don't believe that it is necessary that that language needs to be present for the Department of the Interior to exercise its authority under the negotiated agreement. Under the negotiated agreement, if there are not meaningful reforms, not meaningful actions that have taken place in the year after, the economic group, the advisory group on economic reform had met, then that allows the Department of the Interior to withhold money based on whether or not and how much progress—reasonable and meaningful progress. I think we all recognize during the negotiations that there are going to be some reforms that either are going to take time or just are difficult issues to tackle. But as long as we see that there is an honest movement toward those reforms, either economic or government reform, then the U.S. assistance will continue to occur.

Dr. FLEMING. Secretary Kagan, do you have anything to add to that?

Mr. KAGAN. I think, with response to your specific question, Mr. Chairman, is that in fact was one of the concerns that we have had over the years and one of the reasons why the language was not in the renewals with FSI, FSM and the Republic of the Marshall Islands. So while we believe in principle that ability is there to exercise the appropriate oversight, it certainly is something that has been raised as a concern, and that is one of the reasons why we had issues with the full faith and credit language being in this legislation.

Dr. FLEMING. OK. The Chair yields back and opens the panel for any other questions that you may have.

Mr. Sablan.

Mr. SABLAN. I just have one. Let me get something very clear here, Secretary Kagan and Secretary Babauta, if Congress passes H.R. 6040 in its present form, would either the Department of the Interior or the Department of State recommend its being signed into law? In its present form, the language as presently written?

Mr. KAGAN. I will go first. I think from the Department of State, there would need to be some greater precision in some of the details surrounding the offsets. In particular, we have concerns about some of the legal implications for the State Department with regard to the passport issues.

Mr. SABLAN. We are going back into the technical part, I think that is Dr. Gootnick's expertise.

Mr. KAGAN. Should those things be addressed? I think our view is it is very important that we proceed with living up to our obligations.

Mr. SABLAN. Thank you very much.

Mr. BABAUTA. I was going to say I agree with my colleague and also agree with comments made by Mr. Faleomavaega and Ms. Bordallo earlier and thank the Congress actually for providing the funding that we have been able to continue giving to Palau in the years where the Compact agreement hasn't been passed by the Congress.

Mr. SABLAN. So, if we pass this, we will provide the funding, the Department of the Interior will administer or manage the funds

transfer between the U.S. Government and the Republic of Palau; that is how we do it, correct?

Mr. BABAUTA. Correct. And we do that in close cooperation with our Federal partners.

Mr. SABLAN. Mr. Secretary, one of the best things that happened in the covenant between the Commonwealth, the people of the Northern Mariana Islands and the United States was in the second 702 agreement—so I think some of us are old enough to remember this; I was one of the special representatives—is the provision of the full faith and credit one time. And with the Northern Marianas was able to go out and raise actually using the full faith and credit of the United States raise more money than was agreed to in the agreement. And of course, market conditions were much better then, and is this something that is being considered here? Would that be a possibility for the Republic of Palau?

Mr. BABAUTA. Being able to utilize the language the full faith and credit?

Mr. SABLAN. Yes, they are going to upfront the funding, and it was then that Interior made the annual payment to the bond underwriters or whatever they call that.

Mr. BABAUTA. I am not certain what the motivation would be if the Palau Government continues to seek full faith and credit and how different that would be from us seeking a permanent appropriation, which guarantees that the money is going to be there as well.

Mr. SABLAN. All right. Thank you.

Thank you, Mr. Chairman. I yield back.

Dr. FLEMING. The gentleman yields back.

Any other questions.

Mr. FALEOMAVAEGA. Mr. Chairman, I can't believe we are going through the fourth round now. This will be the last, I promise.

Secretary Babauta, you mentioned something about you have some kind of a joint committee of some sort with the Palauan Government to discuss economic issues or something? Can you explain that for the record?

Mr. BABAUTA. It is not something that is in place right now. It will be in place. It is part of the renegotiated agreement. The only thing that we have been doing with respect to acting is—

Mr. FALEOMAVAEGA. You said three—how many members of the U.S. Government? How many members from Palau? They meet as a joint committee or something?

Mr. BABAUTA. If I recall correctly, sir, it would be equal members from both Palau and the U.S. Government. The deciding member will be recommended by the Palau Government, a list of two or three, and then from that list, the United States will choose the one person that Palau recommends.

Mr. FALEOMAVAEGA. You don't think that it is going to upset Palau that the U.S. will always have the strong hand because they have the money? You know what they say about the golden rule? He who has the gold makes the rule.

Mr. BABAUTA. No, I don't, sir, and one of the reasons why is because this particular part of negotiation was recognized both by the United States and Palau as being needed to continue economic growth in the Republic.

Mr. FALEOMAVAEGA. Well, supposedly the Administration people, a portion of this Committee doesn't agree with what the Palauans say that this is the way it should go as far as economic development goes.

Here is my concern, Secretary Babauta: How can we be making recommendations on economic improvements or reforms the Palauans make if we can't even handle our own economy? Does that make sense?

Mr. BABAUTA. I hear what you are saying. The guiding principles I think initially with the Advisory Group on Economic Reforms will be guided by reports that have already been issued by the International Monetary Fund and also by the Asian Development Bank. So those are already there outstanding.

Mr. FALEOMAVAEGA. Can I get assurance from you, sir, that there is going to be no undue influence on the part of the U.S. To say that this is the way it is going to go, you are not going to get any money?

Mr. BABAUTA. You can have my assurance, absolutely.

Mr. FALEOMAVAEGA. I thank you.

Mr. Chairman, thank you.

Dr. FLEMING. The gentleman yields back.

Any other panel members?

Ms. Bordallo.

Ms. BORDALLO. Mr. Chairman, I have no further questions.

Does my colleague want any more time?

Mr. FALEOMAVAEGA. No.

Ms. BORDALLO. Then, Mr. Chairman, I yield back.

Dr. FLEMING. The gentlelady yields back.

I want to thank the panel today for taking a lot of the hard questions. We put you through four rounds, but we thank you for standing up to the chore and giving us the best answers you can. I am convinced that you were very forthcoming. And while we don't know all the answers today, hopefully together we will be able to work them out.

I would like to also thank the staff for their work today.

Members of the Subcommittee may have additional questions for the witnesses, and we ask that you respond to these in writing. The hearing record will be open for 10 days to receive these responses.

Again, I want to thank all of the staff members, Members here, two Members of the House that couldn't make it today, for all of their efforts as well.

Thank you, and without objection, we are adjourned.

[Whereupon, at 3:48 p.m., the subcommittee was adjourned.]

[Additional material submitted for the record follows:]

Statement of Vikram J. Singh, Deputy Assistant Secretary of Defense for South & Southeast Asia, Office of the Secretary of Defense for Policy, U.S. Department of Defense

Introduction

Since its enactment in 1994, the Compact has served as an important foundation for our security strategy in the Asia-Pacific region, providing the United States with critical access, influence, and strategic denial of access to other regional militaries. Our Compact with Palau, coupled with our compacts with the Federated States of

Micronesia (FSM) and the Republic of the Marshall Islands (RMI), has enabled DoD to maintain critical access and influence in the Asia-Pacific region. Passage of H.R. 6040, a bill to amend Title I of PL 99-658 regarding the Compact of Free Association between the United States and Palau, is vital to allowing the Department to continue to benefit from the security arrangement afforded by the Compact.

Palau's Contributions to American and Global Security

The Pacific Islands region is sparsely populated, physically isolated, and geographically widespread. However, Palau lies at a pivotal crossroad in the Pacific, an area near critical sea lines of communication and rich fishing grounds. It is also located directly in the so-called "Second Island Chain" from Mainland Asia, close to all of the major East and Southeast Asian powers. With our strategic interests and equities expanding and shifting more toward the Asia-Pacific region, having Palau as a strong partner in the Pacific is increasingly important to maintaining military, as well as political and diplomatic, leadership in this quickly evolving strategic environment. We must take note of critical security developments in the Pacific that require the Department's sustained presence and engagement. Broadly speaking, countries such as China, Russia, and the Arab states are actively courting Pacific Island States, challenging the security status quo in the region, and increasing their economic, diplomatic, and military engagement with the island States. These critical security developments require sustained U.S. presence and engagement in the region. Our relationship with Palau under the Compact would be reinforced with passage of this legislation and would ensure the United States the extraordinary advantage to deny other militaries access to Palau. For these reasons, it is imperative that the U.S. Government sustain this advantage. Since the Compact of Free Association between the Government of the United States of America and the Government of Palau went into effect in 1994, the United States has taken full responsibility for the security and defense of Palau. This unique security arrangement has created a steadfast and reliable partner that helps the United States advance its national security goals in the region.

Palau in the Regional Security Context

Under the provisions of the Compact, Palauans are able to serve in the U.S. Armed Forces. In fact, Palauans serve in the U.S. Armed Forces in impressive numbers. Sadly, five Palauans have made the ultimate sacrifice, and numerous others wounded, fighting on the battlefield in Afghanistan and Iraq since 9/11. Their sacrifice in the defense of the U.S. homeland and U.S. and Coalition security interests should not go unnoticed. Furthermore, in 2009, Palau stepped up to offer resettlement to six Uighur detainees from Guantanamo Bay at a time when other countries were hesitant to take these individuals. Most notably, our commitment to the Compact with Palau allows the Department to leverage Palau's strategic geopolitical position to sustain U.S. security interests in the region. The United States exercises full authority over and responsibility for the security and defense of Palau, an arrangement similar to those that we have with the Federated States of Micronesia and the Republic of the Marshall Islands. With this authority and responsibility, the United States is entitled to military access to the lands, water, and airspace of Palau and retains the right to deny such access to the military forces of other nations. Our current security arrangement affords us expansive access, which will be an increasingly important asset in the defense and security interests of the United States in the Asia-Pacific region in coming years. The Department recognizes the strategic value of the Compact, and we hope to continue to utilize it to serve our national security interests.

U.S.-Palau Defense Relations

We have growing national security interests and equities in the Western Pacific, a region that is traditionally overlooked and undervalued. Together with the two other Compact States, the Federated States of Micronesia and the Republic of the Marshall Islands, Palau forms part of an important security zone under exclusive U.S. control that spans the entire width of the Pacific when we include Hawaii and the U.S. territories, Guam and the Commonwealth of the Northern Mariana Islands. Palau's location makes it an important part of the U.S. strategic presence in the Asia-Pacific. The Palau Compact affords us strategic positioning in a country with a unique geopolitical position in the Asia-Pacific. The region's lack of political and security infrastructure has given rise to a trend of growing transnational crime, which underscores the importance of continued DoD engagement in the Western Pacific. With this in mind, the Department seeks to develop creative ways to remain strategically engaged in the region. Recognizing that Palau has no military and only limited law enforcement capabilities and resources, the Department's engagement with Palau primarily focuses on helping them develop maritime security and hu-

manitarian assistance capabilities. First, maritime security has been one of the most fruitful areas of cooperation between our two nations, DoD sends mobile training teams to Palau to help train local security personnel in maritime security-related matters, Palau's Exclusive Economic Zone (EEZ) is part of the Pacific's richest fishing grounds and has traditionally faced serious problems with foreign exploitation of the fishery resources. Large numbers far-ranging fishing vessels from other Pacific nations threaten encroachment. Japan, China, Taiwan, and the United States participate in a highly competitive multi-million dollar tuna industry. The Department is currently reviewing ways to use existing DoD assets and cooperative mechanisms to enhance maritime domain awareness in the region. To combat illegal fishing, the U.S. Coast Guard has entered into a shiprider agreement with Palau, which enables Palauan security officials to embark on transiting U.S. Coast Guard vessels to conduct maritime patrol of its enormous, under-patrolled EEZ. This kind of shiprider agreement allows the U.S. Coast Guard to play a more active role in developing partner law enforcement capacity of the island States. In addition, we are cooperating with Japan, Australia, Palau, the Marshall Islands, and Micronesia to bring to fruition the Sasakawa Peace Foundation's \$10 million initiative to support maritime surveillance in all three Compact States. Second, the Department's humanitarian programs have been very well-received in island communities. These programs primarily focus on the removal of explosive remnants of war from the World War II era, humanitarian projects, and prisoner of war/missing in action operations. DoD's 12-person Civic Action Team maintains a rotational presence in Palau, conducting small to medium scale humanitarian and civic action projects in the health, education, and infrastructure areas. Especially notable are the large-scale, multinational, preplanned humanitarian missions, the U.S. Air Force's Pacific Angel and U.S.

Navy's Pacific Partnership, which include medical and engineering projects in remote regions that are conducted in close coordination with local communities. In the summer of 2010, more than 1,900 Palauans were treated, 14 community service projects were completed, and more than 1,000 man hours spent across the three states of Koror, Peleliu and Angaur when USS BLUE RIDGE (LCC-19) stopped in Palau as part of Pacific Partnership 2010. Also, the longest running humanitarian campaign in the world, Operation Christmas Drop, which provides air-dropped supplies to the people of the remote Micronesian Islands each December, celebrated its 58th anniversary in December 2010 and continues annually to assist the remote islands of Palau. These humanitarian missions are evidence that the Department's engagement in Palau extends well beyond traditional security parameters.

Conclusion

U.S. power projection in the Asia-Pacific region will continue to be important to our national security interests. The U.S.-Palau Compact is a strategic asset for U.S. presence in the Western Pacific, an increasingly important region. Loss of the defense rights and exclusive access granted to the United States under the Compact would adversely affect U.S. national security. Our relationship with Palau is unique and reliable.

